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WILDCAT BANKING PRACTICES

AND THE

DEVELOPMENT OF

STATE BANK SUPERVISION

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CHAPTER I

INTRODUCTION

The term "banker's gray" for years has been accepted as identifying a rather dull and conservative color, thereby at least implying that banking in the United States tends to be characterized in the public mind by this very dullness and conservatism. It is true, of course, that a certain degree of conservatism is--and should continue to be--the keynote of banking; however, banking should not be thought of as being synonymous with "dull." On the contrary, early banking in this country is far from being a dull subject; it is a fascinating story, inextricably interwoven with the history of our country in its rise from the days of the earliest wilderness settlements to its present position among the great nations of the world.

Even at the beginning of American colonization, European economic development long since had passed through the primitive stages and had reached a degree of sophistication that included, among other things, the basic concept of banking and the use of money as a medium of exchange. Undoubtedly, the colonists used coin to purchase their passage to the New World. Once here, however, there was little need for money, and the economic level tended to revert to a relatively primitive stage in which the respective settlers provided for their basic needs by the fruit of their own labor. Thus, even in a situation in which men had knowledge of more advanced monetary systems, the lack of coinage or local provision

for same led naturally to barter, the first and most obvious mechanical means by which men bridge the gap between a desired commodity they cannot produce themselves and the acquisition of it.

Barter, while satisfactory in a primitive society, has definite shortcomings that become almost immediately apparent and eventually become insurmountable. "The inconvenience of barter consists in the lack of coincidence between the persons who desire to exchange, with respect to the commodities, amounts, and qualities. Money overcomes this...."[1] It is at this point that monetary history begins, the point at which direct, item-for-item barter is replaced by some intermediate item selected as a base or benchmark against which other items may be measured and compared.

In the American colonies, the settlers' knowledge of more advanced monetary systems in combination with the developing wilderness environment in which they had to carry out their transactions began a monetary history that has as many colorful and interesting periods as the political history with which it is so closely entwined, and there are frequent instances in which banking in this country has taken on the same "color" as its period of political history. The era of the "wildcat bank" is one such period.

Wildcat Banking

First, precisely what is meant by "wildcat bank"? If such a bank could be personified, it would resemble not so much a wildcat as Shakespeare's Falstaff in its flamboyant dishonesty and abundance of

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[1]William Graham Sumner, "A History of Banking in the United States," A History of Banking in All the Leading Nations, Vol. I, Edited by the Editor of The Journal of Commerce and Commercial Bulletin, The Journal of Commerce and Commercial Bulletin, New York, 1896, p. 28.

trickery. Actually, the term "wildcat" refers specifically to banks that issued irredeemable currency. The practice had its origin in the operations of irresponsible local banks that took advantage of lax state laws to float excessive issues of bank notes, particularly in the rural Middle West. The activities surrounding the note-issuing function generally were equally irresponsible, illegal, and dishonest.

There seems to be some difference of opinion regarding the origin of the term "wildcat bank." Some sources have ascribed it to the remoteness of the location of some of these banks in areas "where wildcats were said to be more numerous than human beings."[2] Others claim the use of this term for such institutions was "derived from a bank of this character whose notes bore a figure of a wildcat."[3]

A third source appears to have a rather high probability of being the true origin of the term. Late in December of 1816, an act was passed in the Missouri Territory "To encourage the killing of wolves, panthers, and wildcats." The act provided that a bounty be paid to any individual who killed one of these animals within a radius of 10 miles of a settlement. The rate varied according to the animal, with wildcats bringing a fifty-cent bounty. The hunter presented evidence of the kill (the scalp complete with both ears) and received in return a certificate directing the county treasurer to pay the amount specified to the hunter or to bearer. These certificates were not payable in gold or silver coin, i.e., specie, but the law provided that they be recognized as legal tender for the payment of county taxes. Because of this provision, the

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[2] Davis R. Dewey, "Wildcat Banks," Encyclopaedia of the Social Sciences, Vol. II, Edwin R. A. Seligman, Editor-in-Chief, and Alvin Johnson, Associate Editor, The Macmillan Company, New York, 1931, p. 454.

[3] New "Standard" Dictionary of the English Language, Funk & Wagnalls, New York, 1952, p. 2712.

"wildcat certificates" began to circulate as currency and are said to have been responsible for application of the term "wildcat" to other currencies that could not be redeemed in metallic currency, particularly to the paper issued by banks in surrounding territories that did not redeem in specie.[4]

Scope and Purpose of Thesis

Of course, neither the name nor its source is important. What is important is a clearer understanding of the environment that could have conceived a type of bank with such attributes, and could have allowed it to endure and prosper for a time.

Wildcat banking is mentioned frequently in writings on various facets of banking and monetary history, but usually it is mentioned only in passing and is dispatched with a few general sentences. This interesting predecessor of present-day banking warrants more than a cursory glance, and it is in this thought that the following pages are devoted to a more in-depth study of wildcat banking.

It was the original intention of the author to limit the scope of this paper to the period between the enactment of the free banking laws around 1838 and the National Bank Act in 1863, which is the approximate period encompassed by the term "wildcat banking era." In the course of research on the subject, however, it soon became apparent that a great many practices that characterized wildcat banking were conceived and implemented well before 1838, and were by no means restricted to the rural Middle West. In the circumstances, the scope of the paper was broadened to cover not only the so-called wildcat banking era, but also

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[4]William H. Dillistin, Bank Note Reporters and Counterfeit Detectors, 1826-1866, The American Numismatic Society, New York, 1949, pp. 61-62.

the earlier period of state banking where first are encountered the unsafe and sometimes unsavory practices, the evasions of law, and the general chicanery that later epitomized the wildcat bank.

A collateral theme in the study of wildcat banking is its relationship to the origin of banking laws and regulations that ultimately evolved into the structure now referred to as bank supervision. One way of showing the evolution of bank supervision is by merely enumerating the succession of statutes and amendments. Although any attempt to show a causal relationship between wildcat bank practices and state laws relating to banking necessarily involves a certain amount of such recitation, it is the author's hope that this less interesting aspect can be blended in with the colorful aspects of wildcat banking--its background, evolution, characteristic practices, demise, and its overall effect--in a way that will make this period of United States monetary history come alive for the reader, and prove to be both interesting and informative.

CHAPTER II

SETTING THE SCENE

Functions of Money

As will be elaborated upon later, the concept of paper money was not unknown in early Colonial days; however, its use evolved over a period of time in the various colonies only after they had progressed through more primitive stages in the search for a suitable medium of exchange. It is appropriate at this point, perhaps, to dwell momentarily on the very basic question of the function of money. Awareness of this function all too often tends to be lost in the daily quest for money and for that which it will buy.

There are two vital and essential functions of money: first, it serves as a medium of exchange, and second, it serves as a standard of value, i.e., a common denominator to which diverse goods may be related. While money has other, lesser functions--serving as a storehouse of value, a unit of accounting and of deferred payment--the first two characteristics are the most important and provide the underlying motivation for the entire banking concept.

Although the colonies possessed considerable wealth, it was in the form of the ingenuity and craftsmanship of its workers and traders and in natural resources other than gold and silver. There was no local coinage in the early period, and such specie--gold and silver coins--as was available was acquired from individuals who immigrated to the colonies and from payment from abroad for Colonial exports.

Alternative Media of Exchange

Despite the obvious lack of a medium of exchange or domestic legal tender so necessary for a normal flow of commerce, legal requirements unrealistically continued to specify that contracts and taxes be paid in silver or gold. An example of the severity of the need was revealed in the words of a Boston merchant in 1720: "'In a little time we shall not have wherewith to buy our daily bread, much less to pay our debts or taxes.'" Commerce slackened due to the lack of acceptable money, and suits were brought against men of honest character and financial substance who, despite their willingness, were unable to pay.[5]

Under the circumstances, it is not unexpected that various substitute media of exchange were tried. Among the earliest such device was wampum--cockleshells. The making of wampum, however, required much labor and patience, and one Indian could manufacture only a few pence worth per day. The English, with their iron tools, could increase production tremendously; therefore, wampum depreciated so that in 1649 Massachusetts prohibited its receipt for the payment of taxes, although it remained legal tender for private debts until 1661.[6]

Beaver and various other kinds of peltry were used widely because of the ready market for furs in Europe. It was relatively easy to convert both pelts and tobacco into coin or its equivalent. Early

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[5] Bray Hammond, Banks and Politics in America from the Revolution to the Civil War, Princeton University Press, Princeton, New Jersey, 1957, p. 11.

[6] Charles J. Bullock, Essays on the Monetary History of the United States, The Macmillan Company, New York, 1900, p. 8.

Massachusetts records indicated that "'it is further ordered, that corne shall passe for payement of all debts at the usuall rate it is solde for, except money or beaver be expressly named.'"[7]

Maryland and Virginia used tobacco as a principal medium of exchange. In the Carolinas, rice and tar were used; in other colonies, at various times, official recognition was given to wheat, oats, barley, peas, bacon, pork, fish, flax, wool, sugar, brandy, whiskey, and musket balls.[8] Several colonies tried to make land as well as various commodities legal tender. Generally, this did not work out well because of disagreements regarding values, which were difficult to establish in an ever-developing economy that was stimulating the demand for imports, which in turn was stimulating the need for specie.[9] Various land banks, i.e., banks issuing paper money on the security of mortgages, were organized, especially in Massachusetts around the late 1600's and early 1700's, but they were generally unsuccessful.[10]

The plight of the Colonists throughout the entire pre-Revolutionary period can be summed up in a resolution that grew out of one of the very early complaints before the General Court of Massachusetts in 1641, complaints said to be so typical as to be applicable throughout the period:

> "'Whereas many men in the plantation are in debt, and heare is not money sufficient to discharge the same, though their cattle and goods should bee sould for halfe their worth, as experience hath showed upon some late executions, whereby a great part of the people in the country may be undone, and yet their debts not satisfied....'"[11]

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[7] Bullock, pp. 9-10.

[8] Bullock, p. 10.

[9] Hammond, p. 11.

[10] N.S.B. Gras, The Massachusetts First National Bank of Boston, 1784-1934, Harvard University Press, Cambridge, Massachusetts, 1937, p. 7.

[11] Bullock, p. 2.

The record shows that, being obviously sympathetic to their cause, the court granted relief to these insolvent debtors.

That this situation continued to plague the colonies is evidenced in the fact that almost 150 years after the above court action it could be said that

> "It was this dearth of specie, the only legal tender, that in 1786 drove the Shays rebels in Massachusetts to demand a medium with which they could protect their farms from tax sales--though the dearth at that time coincided with no unusual surplus of imports. The difficulty was general and persisted into the 19th Century."[12]

Colonial Paper Money

The colonists did not omit paper from the list of commodities used in their experiments with substitutes. Paper bills of exchange apparently circulated in Massachusetts prior to 1652; in 1661, John Winthrop, Governor of Connecticut, considered "some proposalls concerning a way of trade and banks w^th^out money."[13] "In 1671, 1681, and 1686, private banks were actually established in Massachusetts; and bills were issued, probably upon the security of /goods and merchandise and land/ not subject to perishing or decay."[14]

All in all, there were numerous issues of paper currency during this period, put out by the various colonies in the late 1600's and well into the 1700's. The currency had become quite common, and depreciation of it was severe and constant. This paper should have been redeemed by tax collection; however, the various Colonial assemblies tended not to levy

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[12] Hammond, p. 11.

[13] J. H. Trumbull, First Essays at Banking in New England, Worcester, 1884, pp. 8-9 (as cited in Bullock, p. 31.)

[14] Bullock, p. 31.

enough taxes to redeem it, so the currency accumulated and depreciated at a continuing pace.[15]

It is noted, however, that some colonies actually were successful in meeting the need of a domestic medium of exchange. Benjamin Franklin had advocated paper money in Pennsylvania and there it had worked well. Thomas Pownall, a former Governor of Massachusetts and South Carolina, stated in his study of Colonial administration:

> "'There never was a wiser or a better measure'...'never one better calculated to serve the uses of an increasing country,...more steadily pursued or more faithfully executed.' Governor Pownall distinguished Pennsylvania's success /of the paper currency/ from the 'outrageous abuses' in other colonies and 'the great injury which the merchant and fair dealer'[16] had suffered from them.
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> "The bills of credit of the colonial governments had at first been issued to meet official expenses, especially for military expeditions against Indians and the French. Later they were issued principally by lending at colonial loan offices, which in exchange for the bills took mortgages on the borrower's real property. The former bills were spent, the latter lent. But the difference was of no necessary importance to the bills as money. Either might be over-issued; either might be kept equal to specie in value, or not. The private associations or 'banks' put their bills in circulation by lending them on mortgage security as the loan offices did; and the two were therefore parallel or alternative methods of providing a circulating medium, the one public, the other private."[17]

When the various colonies needed money to finance the Revolutionary War, they had been schooled by years of unsound financial methods, which included the issuance of paper currency, the lack of sufficient taxation to redeem it, the issuance of more paper currency that further depreciated that which was outstanding, and so on. Despite the unsatisfactory

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[15] Bullock, pp. 34-35.

[16] Thomas Pownall, The Administration of the British Colonies, London, 1768, pp. 185-188 (as cited in Hammond, pp. 11-12).

[17] Hammond, pp. 10-12.

experience of the past, they were so accustomed to the idea of paper currency that it was only natural that the Continental Congress should follow the practice of the various Colonial assemblies with respect to financing.[18] Thus, the use of paper money became relatively common. It should be noted, however, that the issuance of currency by these various governmental bodies was merely that; it was not the function of banking in the usual sense of the term.

Banking Function Evolves

It is appropriate to clarify at this point the different senses in which the term "bank" was used in 18th century America.

> "First, the word was used of corporate institutions--the Bank of England for example--of which, however, there was none in America until 1782. Second, it was used of an issue of bills of credit by a colonial government: Rhode Island, for example, might emit 'a bank of £40,000.' This use became obsolete before the century ended. Third, it was used of an association of private persons who issued their own bills of credit."[19]

Despite the fact that there were no banks along the lines of these institutions as we know them today, and in the absence of an adequate supply of specie or of an acceptable alternative, it was necessary--even before the establishment of chartered banking institutions--for someone or some group to carry on a banking function. Inasmuch as the general store naturally tended to be the center of business life in most communities, circumstances forced every such merchant to carry on in some way the function of a banker.

> "The country storekeeper's trade was based principally on a system of barter and whatever money there was in a neighborhood usually found its way into his pockets, and thus he naturally became the banker for the community. Notes

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[18] Bullock, pp. 60-61.

[19] Hammond, pp. 9-10.

were given for trifling amounts, even for a few shillings, and the storekeeper accepted these notes in payment for groceries and other commodities. Men who had credit would pay small accounts by orders for certain commodities, directed to the storekeeper, and the storekeeper would be asked to advance cash in small amounts when nothing else would suffice."[20]

The growth of this merchant-banker relationship is illustrated by the activities of Thomas and John Hancock, Boston wholesalers and retailers, who not only made transfers of credit for their customers, but also made investments for them.[21] This relationship gradually became more oriented toward banking than toward merchandising, and provided the foundation for institutions devoted exclusively to the business of banking.

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[20] Historical Directory of the Banks of the State of New York, William H. Dillistin, Compiler, New York State Bankers Association, New York, 1946, p. xii.

[21] Gras, p. 7.

CHAPTER III

CHARTERING OF STATE AND FEDERAL BANKS

National Coinage System

The next phase in the development of banking occurred after the Revolution. Congress made no provision for a paper currency. Instead, it established a bimetallic national coinage system in 1792 by providing for the circulation of standard gold and silver coins. The ratio adopted was 15 grains of silver to one grain of gold. While this valuation approximated the actual market values of the metals at the time the law was enacted, the price of silver soon dropped, with the result that gold was driven out of circulation and our first coinage, in effect, was almost one of silver monometallism.[22]

According to a report to the House of Representatives by a committee on coinage in 1819, gold, because it was underrated, "can scarcely be considered as having formed a material part of our circulation for the last twenty-six years."[23] Not only had gold completely disappeared some 20 years after the adoption of the 1792 ratio, but even American silver coins were supplanted by lightweight Spanish money. In consideration of the latter situation, President Jefferson suspended the coinage of silver dollars after 1806. Nonetheless, gold and silver

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[22] Charles J. Bullock, Essays on the Monetary History of the United States, The Macmillan Company, New York, 1900, pp. 79-93.

[23] State Papers, Finance, Vol. III, p. 399 (as cited in Bullock, pp. 79-80, footnote 3.)

coins were considered the legal currency of the United States, the coinage provision having been an outgrowth of a strong antipathy to, and an awareness of the evils of, a paper medium.[24]

Advantages of Convertible Paper

Paper currency now is so taken for granted it is difficult to conceive of a time when it did not exist, and its great value in terms of convenience tends to be overlooked. Contrary to the nonconvertibility of today's currency, the currency issues of the early banks were the promises of the banks to convert the paper into specie on demand. In an era accustomed to the use of gold or silver coinage, a paper currency that could readily be converted into current coin at the option of the bearer had several very attractive features. Assuming, of course, that the issuing bank was one that enjoyed public confidence, the bank notes well might have been preferred to specie.

A great amount of stress is placed on public antipathy to paper currency in early writings on banking. Certainly the depreciating values and other faults of many of the early paper notes deserved this rancor, because the loss of purchasing power wrought great hardship on vast numbers of people. The only real evil effect of paper currency on the public was its inconvertibility; as a practical matter, the great facility with which paper could change hands made it preferable in many ways to money of intrinsic value. Among the advantages were the greater ease with which paper could be carried, counted, identified, and hidden away for safety.

On the other hand, the time, effort and expense involved in transactions involving the transfer of large sums of coin was monumental.

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[24] Bullock, p. 79-92.

For example, 100,000 silver dollars weighed 6,600 pounds, "equal, in the transport, to two ordinary wagon-loads; to say nothing of the time required to count it, and the precautions to protect it."[25]

Following the poor experience with paper issues of the Revolutionary War period, the Federal government had rejected, at least temporarily, any further consideration of adopting a paper-money policy. However, there was no cessation of the clamor for a cheap currency. The opportunity for bringing this desire to fruition was made available in the development of banks of issue.[26]

Had there been an adequate supply of metallic currency, and/or had Congress adopted a ratio of gold to silver that would continue to reflect current values, the banking system might have developed along different lines.

Chartering of Banks of Issue

It should be emphasized here that banking in the United States was characterized from the beginning by the fact that the institutions were banks of circulation rather than banks of deposit. In the banks of deposit, such as those in Venice and Amsterdam in very early days, a transfer was made on the books as directed by a written order of the owner of the funds deposited with the bank. These banks, although they issued receipts for the amounts deposited, never circulated the receipts, and these instruments never acquired the characteristics of currency. In contrast, banks in this country in the early period issued paper

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[25] George Tucker, The Theory of Money and Banks Investigated, Charles C. Little and James Brown, Boston, 1839, p. 177.

[26] Bullock, p. 82.

currency, which was circulated and which performed the functions of a medium of exchange.[27] Loan proceeds, for example, were not credited to the borrower's account, but were disbursed in currency.

The first bank in the United States "that undertook to maintain a bank currency that should be at all times convertible into specie" was the Bank of North America.[28] This bank, founded in 1781, was the first chartered by Congress and had as its base specie obtained by the Federal government from France. The Bank of Massachusetts began operations with a total capital of $300,000 of which $253,500 had been collected in specie. This very conservative relationship of specie to total capital was possible to maintain in the earliest period; however, this country still did not have a great supply of precious metals, so the conservative dedication to specie was found to be an impossible rule when banks began to multiply in number.[29] Reaction to the convertible currency first implemented by the Bank of North America was more than favorable and, as a result, banks were founded in Boston and New York in 1784, and "before long a banking mania spread in all directions." For example, banking came to the Mississippi Valley as early as 1802 when a bank was established in Kentucky; moving even farther into the burgeoning frontier, bank operations began in Missouri when such an institution was established in 1813.[30]

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[27] Tucker, p. 160.

[28] Bullock, p. 81.

[29] Davis R. Dewey, State Banking Before the Civil War, The National Monetary Commission, Washington, 1910, p. 5.

[30] Bullock, p. 81.

First and Second Banks of the United States

Even though "the very word bank was regarded with suspicion and distrust" in Revolutionary times,

> "...there were...a few financiers, men of large affairs, who were well informed on matters of finance. Among them the most prominent were Robert Morris and Alexander Hamilton. Hamilton is on record as having entertained the project of forming a bank as early as 1779. He wanted a national bank principally for the purpose of issuing notes. He was impressed with the great need of the country for a sufficient circulating medium and fully recognized the importance of having that medium reliable and secure."[31]

Hamilton submitted a paper to Congress in late 1790, outlining his ideas on establishing a national bank. Many of his ideas already had culminated in the charter of the Bank of New York, which was his creation, and which

> "...became the model on which numberless charters were afterwards constructed, and the charter of the Bank of the United States, which he now proceeded to make, was taken as a model by so many others that we must attribute to his opinions on banking a predominant influence in forming the banking institutions of this country."[32]

Hamilton felt that increasing the quantity of money would lead to actual increases in capital, have procompetitive effects on prices, and help the discharge of individual indebtedness. The fact that such a notion never failed to win popular acclaim undoubtedly helped add weight to the already great influence of the Hamilton name in recommending such a theory for public acceptance.[33]

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[31] Historical Directory of the Banks of the State of New York, William H. Dillistin, Compiler, New York State Bankers Association, New York, 1946, pp. xii-xiii.

[32] William Graham Sumner, "A History of Banking in the United States," A History of Banking in All the Leading Nations, Vol. I, Edited by the Editor of The Journal of Commerce and Commercial Bulletin, The Journal of Commerce and Commercial Bulletin, New York, 1896, p. 22.

[33] Sumner, p. 23.

The chartering of the first Bank of the United States was an important step in American monetary history. Writings on the background, purposes, functions, innovative features, and controversies surrounding this institution and its successor, which existed from 1791 to 1811 and from 1816 to 1836, respectively, have filled numerous volumes and are complete subjects unto themselves. In the circumstances, they will be given very brief coverage here, citing only those aspects that are necessary for purposes of this discourse.

The first Bank of the United States was chartered in 1791 in accordance with Hamiltonian theory, and--in further accord with his theory--issued legal-tender currency based largely on government securities, a practice followed by the Bank of England. The charter provided that only one-quarter of the government-subscribed capital of $2 million was to be payable in gold and silver and that the remainder was to be in government stock. (The same method was followed in capitalizing the second Bank of the United States in 1816.)[34]

The Bank, with total capital of $10 million, served as a depository and fiscal agent of the government. Because its own notes were convertible to specie on demand, and because it refused to accept any inconvertible bank notes, it succeeded in establishing a sound paper currency.[35]

There was great antagonism to the Bank, stemming in part from the political prejudice of the strongly pro-States'-rights opposition party and in part from the view of many that the chartering of a bank by the

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[34] Dewey, p. 5.

[35] Francis G. Walett, Economic History of the United States, Barnes & Noble, Inc., New York, 1957, pp. 101-102.

government was unconstitutional. Consequently, the Bank's charter was not renewed at its expiration in 1811.[36]

The second Bank of the United States was chartered in 1816, it having become apparent that a national bank with its own legal tender and actions that assured convertibility of notes of others was needed. It had been a mistake to allow the charter of the first Bank to expire. Impetus for the second Bank came from the financial needs of the War of 1812 and subsequent need to re-establish convertibility of paper to specie, a practice that had been suspended by all but some New England banks in 1814.[37]

Despite the need for the functions it performed, there continued to be strong opposition to the Bank. State banks resented being forced to resume specie payment, and States'-rights theorists continued to oppose this Federal institution. The public lost confidence in this and in all banks in the difficult times following the Panic of 1819.

The Panic of 1819 created a period of liquidation, and the currency supply of the nation was greatly contracted. Without going further into details--which deal largely with the operations and, in some cases, the mismanagement--of the Bank of the United States, it is merely noted here that the great deflation that took place was generally worldwide. It greatly affected the flow of gold from one country to another, and, although the details are not important to the progress of this paper, it is clear throughout the discourse on the liquidation that the events that transpired during this period were largely responsible for

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[36] Tucker, p. 360.

[37] John R. Kirk, Jr., The Development of Bank Supervision in the United States, Federal Deposit Insurance Corporation, Washington, D. C., 1949, pp. 6-9.

the hatred that developed toward the Bank of the United States, particularly by the agrarian societies in the less developed states.[38] It is not surprising that the charter of the second Bank was not renewed at its expiration in 1836.

Effect on State Banking

The void left by the demise of the national bank with its extensive branch system triggered great expansion in state banking. The number of banks grew from 12 to 89 during the 1791-1811 charter of the first Bank of the United States. This number rose to 330 (with capital of $145 million) in 1830, and to 829 (with $317 million capital) by the beginning of 1838. The latter figures reveal the magnitude of expansion in banks to fill the void left by the demise of the second Bank of the United States in 1836. This proliferation of banks and the attendant swelling of note circulation contributed to the general suspension of specie payment and the Panic of 1837.[39]

Overall, American banks in the period 1815 to 1840

> "...were widely considered to be public blessings and therefore were multiplied all over the countryside. Thus through the extension of country banking, the trend toward lower standards in banking begun with the first wave of bank charters in the middle of the 1790's was not only not arrested, but even accelerated; and in the 1820's and 1830's American banking reached its moral and managerial nadir."[40]

It can be said that "state banks were created not because capital was seeking investment nor because places with established commerce and

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[38] Sumner, pp. 112-118.

[39] Tucker, pp. 360-362.

[40] Fritz Redlich, The Molding of American Banking, Part I, 1781-1840, History of American Business Leaders, Vol. 2, Hafner Publishing Company, Inc., New York, 1947, p. 43.

manufacture needed bank accommodations, but because men without capital and credit wanted loans."[41]

The tenor of the people of the agrarian West is exemplified in the case of the Indiana Territory, which also was suffering a shortage of currency. It was said that, not only did wildcat banks flourish, but

> "...so great was the prejudice of the western Democrats against a national bank that they would rather endure all the evils of a private bank system than see a national currency circulated by one strong bank. This prejudice is accounted for if we recall that the Second United States Bank, when it went into business at the beginning of the year 1817, broke 165 of the 446 state and private banks then in existence; and that of $90,000,000 of their notes in circulation it stopped $30,000,000. The whole debtor class--a large majority of the pioneers--favored the private banks because it was much easier to borrow money from them. Paper money, at this time, ranged in value all the way from the notes of Massachusetts banks, worth twenty per cent more than the treasury notes of the United States, to the counterfeits that deluged the country."[42]

The overriding motive of the bankers, of course, was profit. At the end of the 18th century, banks were paying dividends of 8 to 15 per cent, which provided great stimulus for the chartering of more such institutions.[43] Although the behavior of some of these bankers can be attributed to naivete and simplicity, it was early bankers

> "...who invented all the later abuses, and they set about the exploitation of them with less reserve than their successors. Perhaps they and their contemporaries had not yet learned how mischievous the abuses might become. If so, that is the most which yet can be said for them; for they did not show any greater scrupulosity than their successors. The fact is that what New England did in the first decade of the century is what the Middle States did in the second, and the Southwest in the fourth, and the Ohio States in the sixth."[44]

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[41] Redlich, p. 43.

[42] Logan Esarey, State Banking in Indiana 1814-1873, Indiana University Studies, No. 15, Bloomington, Indiana, 1912, p. 221.

[43] Sumner, p. 35.

[44] Sumner, p. 37.

CHAPTER IV

THE BEGINNINGS OF BANK SUPERVISION

It requires but a glance at the history of the United States to suggest that bank supervision would be virtually impossible to trace in other than a broad, general way. The country had grown from the days of the colonies, through the Revolutionary period, to the period of statehood and territorial expansion. In each period, separate legislation was adopted by separate political entities. The result was a vast body of laws, amendments, individual bank charter provisions, regulations, and other documents relating to bank supervision. Undoubtedly, many of the historical documents are either no longer extant or are impossible to locate; finding and researching those that exist would be a lifetime undertaking. Fortunately, history records the more important and significant developments, and these provide a reasonably clear picture of the evolutionary process that took place in bank supervision through the state banking era.

Prevailing Air of Mystery

The first noteworthy aspect of this subject is that it was not felt in the early days that the public had a right to any details concerning a bank.

> "Thomas Welling, of Philadelphia, wrote to Thomas Russell, of Boston, that 'the world is apt to Suppose a greater Mystery in this sort of Business, than there really is. Perhaps it is right they should do so.' Thus did the sedentary merchant and

> banker in one city give to a fellow merchant in another city the idea that in the bank to be founded there should be mystery."[45]

Keeping the public uninformed was not a new idea, but was quite in keeping with the position historically taken by the Bank of England and its predecessors in Venice and Amsterdam. It is not surprising, then, that early banks in this country maintained the same air of mystery and concealment as to their transactions and the assets employed.

The prevailing attitude was slow to change, because the banks apparently equated secrecy and safety. It was only when the feared results of publication did not ensue that the theory of disclosure of heretofore secret information could develop to the point of being translated into charter provisions. The inclusion in bank charters of the requirement for revealing financial data was done in the thought that such publicity would increase the confidence of the public in those banks that were well managed and, at the same time, it would expose the weaknesses of those suffering from poor management or other undesirable influence.[46]

Early Supervisory Provisions

A charter granted in 1792 to the Union Bank of Boston appears to contain the first provision for an examination more in line with the current mode than with the limited type specified for the first Bank of the United States and for countless individual charters granted by the

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[45] N. S. B. Gras, The Massachusetts First National Bank of Boston, 1784-1934, Harvard University Press, Cambridge, Massachusetts, 1937, p. 14.

[46] George Tucker, The Theory of Money and Banks Investigated, Charles C. Little and James Brown, Boston, 1839, pp. 210-211.

several states.[47] However, this seems to have been unique in that it was not incorporated in other bank charters around the time, nor was the concept of submitting to regular examinations to become accepted for several decades.

In actuality, early requirements and provisions were much more limited. They fell into roughly three general categories. The first requirement usually specified that all, or some stated part, of the bank's stock should be purchased with specie. The second placed some limit on the size of the note issue, the amount usually being some percentage of the bank's capital. The third involved a provision for either the submission of periodic reports or some sort of inspection by the legislature. The reports ordinarily called for data regarding the amounts of capital, debt, deposits, and outstanding currency, as well as the amount of gold and silver on hand. These reports were required only once or twice per year and were usually submitted to the legislature or to some specified state officer.[48] There is no indication that the reports were intended to serve a supervisory purpose; the figures seem to have had value only as general information. There is no evidence or suggestion that they triggered action of a supervisory nature.

Although by 1830 a number of the coastal states made the submission of periodic reports a condition in granting bank charters, the banks seldom complied, and there was no legal enforcement mechanism.[49]

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[47] Fritz Redlich, The Molding of American Banking, Part I, 1781-1840, History of American Business Leaders, Vol. 2, Hafner Publishing Company, Inc., New York, 1947, p. 92.

[48] Davis R. Dewey, State Banking Before the Civil War, The National Monetary Commission, Washington, 1910, p. 128.

[49] Dewey, p. 133.

Early developments of note took place at the Federal level. The charter of both Banks of the United States required that the Bank furnish the designated officer at the Treasury with various statements as often as he specified, but not more than once a week. The statements included capital stock and debts due on it, total deposits, total currency in circulation and the amount of specie on hand.[50] It is important to note that the reporting requirement was enforced.

Even more important was the provision in the charter of the second Bank for examination of its general accounts, and for inspection of its books and its operations by the Secretary of the Treasury or a Congressional committee. This examining provision also was enforced. Even though investigation by the Secretary of the Treasury or the committee was not a regularly performed function that could be termed supervisory in nature, the fact that the investigation was made was extremely important as a precedent. It provided historical support for the principle of the right of the chartering body to physically enter the bank, examine its records, and appraise its management and operations.

Two points should be stressed here. The investigation stemmed from purely informational or political considerations, not from considerations related to bank supervision, and the scope of the investigation was quite limited, specifically excluding the right to examine accounts of private individuals, and generally limiting the scope to a few designated accounts to the exclusion of everything else.

Issuance of Bank Stock

Bank capital, already somewhat unstable, became the object of flagrant abuses, even though provisions relating to payment for bank

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[50] Redlich, p. 92.

stock were usually among the first to be included in charters. Although subscriptions ordinarily were payable in instalments spread over a one-to-four-year period, it was not at all uncommon for subscribers to pay only the first instalment, receive the stock, and, in turn, pledge same to the bank as security for a loan with which to settle the remainder of the obligation. In this way, it was easily possible for speculators actually to get something for nothing. By putting their own stock notes into the bank in lieu of cash, then pledging the stock, the dividends paid by the bank most likely would exceed the interest on the stock notes, with any difference being a clear gain to the shareholders who had not put up any money of their own.[51]

Charters usually required that a specified amount of capital be paid in specie. In a number of instances, the specie basis represented as little as 5 per cent of capital, this being the amount paid in the first instalment. It was said that most banks organized after 1812 did not come into being because of the needs of local commerce and industry where the banks were established. Rather they were organized by individuals who had no money of their own--individuals who lacked community stature and creditworthiness--who used the bank as a means of obtaining funds.[52]

For the most part, early state charters carried a provision that the state should subscribe for some share of the capital; however, this provision did not necessarily refer to money, but rather to stock or bonds. This procedure was followed in various instances, including the Bank of Pennsylvania in 1793, and the Bank of America in New York in 1811. Thus,

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[51] Dewey, p. 6.

[52] Dewey, p. 7.

it was almost from the earliest days of banking in this country that the idea of a specie-based currency was observed more in the breach than in the practice.[53] Moreover, as in the case of the other provisions noted, there is no indication that this participation by the state ever was intended to be, or was used as, a tool of supervision in creating or maintaining a sound institution.

The method by which partial specie payment was used in beginning a bank followed a procedure generally along the following lines. The initial instalment called for cash, and this was only a small portion of the total value of the stock. The receipt of this cash permitted the bank to invest in the necessary furniture and fixtures to commence business, including that most important item, the expenditures for engraving and printing its bank notes. Hopefully, a small amount of cash was left with which to meet contingencies. The bank immediately began to discount loans, disbursing the funds in paper money. The hard cash was used primarily for purchases in distant areas where the notes of the instant bank were not acceptable; in the immediate locality of the bank, its notes were acceptable in lieu of specie for normal day-to-day trade.[54]

When the time arrived for paying the remaining successive instalments (usually 25 per cent each, or less), the stockholders were called upon for payment. This was the point at which conservatism departed. In many cases, the stockholders pledged their stock to the bank, obtained a loan on the stock as security, and used the loan proceeds to pay the

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[53] Dewey, pp. 5-6.

[54] Dewey, pp. 7-8.

balance. While some paid in currency, it generally was that issued by the bank itself or by a like institution. The result was the formation of bank capital by exchanging one type of promise to pay for another type of promise to pay and represented no real contribution of capital from the resources of the stockholders.[55] The mechanics of the individual transactions are less important than the fact that transactions of this general order were the rule and not the exception.

One of the earliest methods directed at stopping the above practice of evading the principle of a specie-based currency was the including of explicit provisions in the charter that money should not be loaned to anyone until evidence had been presented to a specified authority that the entire amount of capital actually had been paid in and was in the vault in the form of gold, silver, or other metals. Such provisions were included in Massachusetts charters beginning in 1804. Despite the obvious good intent of the legislation, the restrictive provisions were insufficient to stop the practice. It was shown subsequently that banks had borrowed the entire amount of necessary gold and silver from other banks, displayed it for the benefit of the officials, then returned it to its rightful owner. In many instances this was accomplished in one day.[56]

Charter provisions in subsequent years attempted to close the loophole of the borrow-display-return device described above. The provision called not only for specific proportions to be paid in gold and silver and for examinations by commissioners to verify the presence of the cash, but also for the officials to take oaths of the directors that bona fide

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[55] Dewey, p. 8.

[56] Dewey, p. 9.

payment had been made by the stockholders, that the funds would remain on hand, and that dividends would not be declared until the entire amount of capital had been paid.[57]

Massachusetts was not alone in inserting such charter provisions as a means of assuring specie payment; others--Rhode Island, Connecticut, Maine, and New Hampshire, to name but a few--followed similar procedures in an attempt to eradicate similar abuses.

Distribution of Stock

Another provision inserted in charters related to offering initial subscriptions simultaneously in several areas, and it also specifically limited the size of the block of shares that any individual could purchase. The purpose was to prevent undue concentration of money power in the hands of a few. The device was powerless, however, because attorneys subscribed for shares on behalf of individuals and the unwanted aggregation took place despite the supposed preventive measure. Actually, the device was not only ineffective against the practice it attempted to preclude, but in fact, it provided a disservice in that it tended to spread ownership in a way as to give out-of-state owners an undue amount of control over local banks. There were complaints in various New England states with respect to efforts of outsiders--especially New York residents--to garner control of New England banks in order to secure loans and circulate bank notes in other states. The individuals--actually speculators--then made every effort to buy up the bank notes at a discount in order that they might again lend them. Reportedly, the failure in 1838 of the

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[57] Dewey, p. 10.

Roxbury Bank, Massachusetts, was due to such tactics by New York residents who owned its stock.[58]

As in other instances, some attempted remedies themselves were turned to purposes of corruption. Charters issued in 1811 in New York provided for appointing special commissioners to supervise stock distribution. These commissioners, designated by the legislature, garnered for themselves and a few favorite friends the majority of shares.[59] Records of banking in this period contain numerous other examples in which political intrigue provided the basis for stock distribution. Apparently, it was in relatively few instances that the charter provisions actually served the purpose intended, and individuals--both local and out-of-state--were able to accumulate substantial holdings, preventive efforts to the contrary.

Another form of charter provision regarding stock distribution is illustrated in the case of Indiana. In view of the availability of foreign, i.e., out-of-state, capital together with a fear of foreign capitalists, the 1834 charter of the State Bank of Indiana provided that no foreigner could be a director or serve as president of the bank or its branches. First call on bank stock was given to citizens of the state, and arrangements were made to lend them money for their subscriptions. In the charter of 1855, foreigners were prohibited from voting their stocks, and all directors were required to be residents and citizens of the state.[60]

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[58] Dewey, pp. 22-25.

[59] Dewey, pp. 24-33.

[60] Logan Esarey, State Banking in Indiana 1814-1817, Indiana University Studies, No. 15, Bloomington, Indiana, 1912, pp. 243-244.

Again based on the fear that banks would be controlled by the hands of a few, charters often contained provisions whereby the number of votes per stockholder declined as the number of shares increased. For example, the 1834 charter of the State Bank of Indiana applied the one-man, one-vote rule to holdings of one to four shares. Beyond that, the number of votes was scaled down relative to the number of shares, with provisions for a maximum of one hundred votes per individual regardless of shareholdings.[61]

Stockholder information was not made public. A law enacted in 1815 in the Territory of Indiana attempted to eliminate this secrecy while adding other restrictions (although it was considered undemocratic to limit banking operations by law in any way). There were several banks at this time and the legislature passed "An Act to Prevent Swindling," which called for the publication of the names of individual stockholders rather than merely the name of the firm. This piece of legislation was aimed at a particular banking firm then operating at Lexington under what was generally considered to be "swindlers."[62]

Note Issuance

An outrageous over-issuance of notes was perpetrated by Farmers' Exchange Bank in Rhode Island. In 1808, Andrew Dexter acquired all the outstanding shares of the bank, using little or no cash. Then, replacing the directorate with a new group of his own choosing, he began in January of 1809 "writing constant letters from Boston to urge the cashier to sign the notes as rapidly as possible and send them to him in great quantities,

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[61] Esarey, p. 244.

[62] Esarey, p. 226.

with complete secrecy. He also gave orders that notes should be redeemed only by drafts on Boston or with vexatious delays."[63] Investigation by a committee of the legislature, whose attention finally had been directed to this matter, found the bank to have specie in the amount of $86.48 against a note issue estimated at $580,000. The exact amount could not be determined accurately because of the confused state of the ledgers.[63]

Knowledge of the above-described ruinous activities by Dexter in the Farmers' Exchange Bank caused the Rhode Island legislature to enact statutes levying a fine of $50 for every check or note or bill a bank officer signed if under $50 and payable at an out-of-state location. Similarly, individuals were subject to a $5 fine for passing a note in denominations of under $5 issued by an out-of-state bank.[64] The protective aspects of the legislation were obviously beneficial but the law may have proved to be a disservice to individuals having the forbidden notes in their possession.

Dexter was able to circulate the tremendous volume of notes of Farmers' Exchange Bank by employing the device of swapping them for notes of banks located at a considerable distance. Should a bank issue an unduly large amount of notes in its own locale, the very fact of their abundance well might draw attention to them. This might result in a much greater demand for redemption; however, by distributing instead the notes of a bank located at some distance, or of several banks widely scattered, the likelihood of demands for conversion of these notes into specie was rendered negligible. Quickly perceiving the advantages of

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[63] William Graham Sumner, "A History of Banking in the United States," A History of Banking in All the Leading Nations, Vol. I, Edited by the Editor of The Journal of Commerce and Commercial Bulletin, The Journal of Commerce and Commercial Bulletin, New York, 1896, p. 38.

[64] Sumner, p. 39.

such a scheme, Dexter first used Farmers' Exchange Bank and Berkshire Bank at Pittsfield, Massachusetts, and subsequently brought in other currency to Farmers' Exchange Bank, including notes of a bank in Marietta, Ohio.[65]

This flagrant case and other similar examples of over-issuance became public knowledge and were responsible at least in part for the imposition of limitations on the issuing function becoming a common feature in bank charters. Although the amount varied, a typical ceiling on currency issuance was an amount equal to twice the paid-in stock.

Note Redemption

Each piece of currency carried on its face the issuing bank's promise to redeem the paper in specie on demand. As in the case of over-issuance of notes, the failure to redeem them was not an uncommon occurrence, although both abuses became so flagrant in later times that they tend to be associated primarily with the period of free banking, especially banking of the wildcat variety.

It was customary, therefore, to include among charter provisions specific penalties to be assessed in the event a bank failed to redeem its notes. The penalty varied considerably from state to state. Massachusetts subjected banks to a penalty of 24 per cent per annum on all notes they refused to pay, while the Pennsylvania legislature, apparently of the opinion that a 12 per cent rate was a sufficient deterrent, included such a provision in its charters.[66] There are indications that these penalties actually were demanded and paid without need to resort to litigation, even when the suspension of specie

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[65] Sumner, p. 38.

[66] Tucker, p. 210.

payment was on a broad scale--as in a whole section of a state--as opposed to suspension by one bank.

Both the fact and the payment of the high penalty rates suggest the intensity of public feeling against irredeemable paper currency. A committee of the Pennsylvania legislature, describing the results of inconvertible issues, said in 1820 that they not only drove specie from circulation, but inclined a large portion of the people to live by speculation rather than by labor, generated a prevailing spirit akin to gambling, and caused all manner of property to acquire a fictitious value.[67]

Reports and Inspections

As indicated earlier, the reports requested in charter provisions were generally limited to a statement of the balances of certain accounts--capital, debt, currency issued, and so on. Although some charters re-required reports quarterly, as many or more requested them at less frequent intervals, and they were in no way the detailed reports required of banks today. For example, Virginia, in a charter granted in 1792, required an annual report to the governor "truly stating the situation of the bank and its notes." Some 25 years later, a similar charter contained a requirement for submission of quarterly reports. Not until 1837 was provision made for quarterly examinations by the bank's directors.[68]

Maryland, in creating the Bank of Baltimore in 1795, inserted provisions for annual--or more frequent if required--reports, and an

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[67] Charles J. Bullock, Essays on the Monetary History of the United States, The Macmillan Company, New York, 1900, p. 88.

[68] Dewey, p. 133.

authorization for inspection of the bank's general accounts by the state treasurer. Accounts of private individuals were specifically excluded. The sole stated purpose of this examination was limited to "forming a just opinion of the state of the bank relative to public safety and the profits of the bank." At first, there was no attempt to enforce the reporting requirement. Then, after repeated acts calling for submission of the required statements were ignored by the banks, the legislature imposed a penalty in 1826 and finally achieved compliance.[69]

The foregoing commentary on charter provisions is by no means intended to represent an exhaustive list, but merely touches upon the most common restrictions and requirements in charters of the early period. There are numerous other provisions that either were not so closely related to the bank supervisory function, or were not found so often as to be considered typical.

Issuing a separate charter for each separate bank--with or without enforcement provisions--indicates that it was legislative intent that each bank be bound in a contractual agreement to conform to the provisions enumerated. When the charter is viewed as a contract between state and bank, hence something that could not be violated by bank, it is not difficult to see that banks could find the reverse equally valid. If this line of thinking is pursued, it becomes clear that bankers could regard the subsequent imposition of regulatory provisions--commissioners, examinations, reports, and other supervisory devices--as attempts to violate the original contract. It is not unlikely that this point of view, particularly in a time in which laissez faire attitudes generally

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[69] Dewey, pp. 132-133.

prevailed, would, and probably did, generate banker opposition to the instituting of bank supervisory requirements.

CHAPTER V

CHARTERS INEFFECTIVE AS REGULATORY VEHICLES

The legislating of individual bank charters contained at least the seeds of bank supervision. Although the demands made upon the banks were indeed minimal, the fact that a bank could not operate without first being given corporate existence[70] and being made subject to such safeguards or limitations as the legislature chose to include must be regarded as a glimmer of recognition of the theory that banks are quasi-public institutions, and it is this theory that underlies the entire concept of bank supervision and regulation.

Thus far, the discussion has been confined to the charters and their provisions, but this view of the documents themselves is only one facet of the chartering process, and any conclusions drawn from a single facet are most likely to be inaccurate and misleading. The granting and subsequent actions regarding charters must be viewed in their legislative environment if a true picture is to be drawn. Let it be said at the outset that, although the various abuses, political pressures, subterfuges, and the like are known to have occurred in specific cases, the reader should not be misled into assuming that such was the case with respect to every bank charter, and no such allegation is intended. The extent to which they prevailed is not important; it is the fact that

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[70] For purposes of this paper, the discussion is confined to commercial banking; therefore, the statements are not intended to include other financial institutions such as private banks, savings banks, and plantation banks.

they existed at all that is relevant to the subject of emerging bank supervision.

Lack of Enforcement Powers

One of the major weaknesses of bank charters was lack of adequate provision for enforcing the features they contained. In many cases, it appears the state was willing but felt it had no authority to force the bank to observe charter stipulations and sound practices in general.

A case in Mississippi in 1825 reveals that a special examiner, after having been sent to the Agricultural Bank, reported that the bank continually had ignored the law, had engaged in unauthorized activities, and had followed such flagrant practices as disbursing loan proceeds in notes of another bank (Brandon Bank) at their face value when they actually were selling at about sixty-five cents on the dollar. The examiner indicated the only way he knew of stopping the frauds being perpetrated by this bank was for the legislature to close the bank and cancel its charter. In January of 1840, the governor stated the bank had refused to answer the special examiner's questions.[71]

The examiner clearly was powerless, else he would not have felt the only remedy to be action by the legislature; the state's chief executive officer apparently was equally powerless. The lack of enforcement procedures is abundantly evident in this case, and in countless other situations in which attempts to enforce even meager supervisory requirements proved fruitless.

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[71] William Graham Sumner, "A History of Banking in the United States," A History of Banking in All the Leading Nations, Vol. I, Edited by the Editor of The Journal of Commerce and Commercial Bulletin, The Journal of Commerce and Commercial Bulletin, New York, 1896, p. 325.

Avoidance of Obtaining Bank Charter

Lack of enforcement authority was a prevalent and serious deficiency in the charter approach to banking. Less prevalent but no less serious was an innovative device whereby the charter requirement itself was circumvented! Some individuals found a way to acquire a corporate vehicle without having a bank charter granted by the legislature. One such case is particularly noteworthy because it occurred at an early date--1799--and because Aaron Burr is said to have been the inventor and chief promoter of the charter.

The Manhattan Water Company, chartered in New York City in 1799, had a capitalization of $2 million and the power to use any part of this capital not needed for the water works (supposedly the primary objective of the company) "in any way not inconsistent with the laws and Constitution of the United States or of the State of New York." Although the Chief Justice of the Council of Revision noted and raised objections to the fact that this clause would permit the corporation to engage in commerce, he apparently failed to note that this charter also would permit the corporation to engage in banking. This, of course, was the real underlying purpose of the charter. The use of this devious arrangement allegedly stemmed from the fact that Aaron Burr was not in political favor, and "no charter for a republican bank could then have been obtained." History confirms the fact that the company divested itself of the water works in 1808 and devoted all its capital to banking. Litigation on the matter finally culminated in the affirmation by the State Supreme Court of the right of the company to engage in banking, regardless of the terms and stated purpose of the original charter.[72]

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[72] Sumner, p. 42.

Kentucky also had companies supposedly chartered for some commercial purpose, but which actually were able to engage in banking. Such an organization was the Kentucky Insurance Company, chartered in 1802 to insure boats and cargoes on the Mississippi. Although not authorized in so many words to issue currency, its incidental powers included a provision restricting its bearer notes to pass by delivery only. "On reading the section of the charter it is difficult to say whether it was very craftily or very carelessly drawn."[73] In any event, the political party then in power would not knowingly have allowed a corporate charter containing note-issuing authority to be enacted into law.

One of the most interesting cases of charter circumvention, and subsequent note-issue, occurred in Ohio. This state had put forth great effort in attempting to prevent unauthorized currency. In keeping with this struggle, it forbade all incorporated companies to issue unauthorized notes, and those which did were to be deprived of their charters immediately. Despite various protective measures adopted by banks as well as by the state, attempts were made to circumvent the note-issue prohibition. There seemed to be some question as to the strict definition of unauthorized notes, and these conceivably could be construed not to include all paper, even though some of it was intended to circulate as money.[74]

Among the institutions utilized to take advantage of the situation was a company originally granted a charter as a library in Newtown, Hamilton County. It had sold its books at public auction, and presumably had gone out of business after operating as a library for about 10 years.

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[73] Sumner, pp. 58-59.

[74] Sumner, p. 327.

The shares of this company were purchased in 1840 by some easterners on the pretext of using the corporate shell in connection with establishing a manual labor school; however, they began issuing paper money at once, although there was nothing on hand with which to redeem the currency "except the library, consisting of Harper's family library, some old newspapers, and some rusty novels....The chief book in the collection was a copy of 'Oliver Twist' with engravings."[75]

The above examples indicate that the practice was not limited to a particular geographic area, but occurred in various parts of the states comprising the Union at the respective times. Thus, imaginative individuals, whether or not well motivated, were able to find a way to evade and avoid the cumbersome procedure of obtaining legislative action that they had reason to believe might not have been forthcoming. By avoiding the charter requirement, they also were able to avoid such provisions relating to bank supervision as were then being included in bank charters.

In New York, action was taken in 1804 to prevent such circumventions of the charter requirement. A new statute made it illegal for anyone to engage in banking unless specifically authorized to do so. This "restraining act" very clearly established the principle that banking was not a right, but a privilege to be granted only by specific legislation. Although it might have appeared at first that these restraints were intended to protect the public from irresponsible banking enterprises, events surrounding the enactment of the law reveal no such high motive. At the time this legislation was passed, there were only six chartered banks in the State of New York. Thus, the restraining act legally protected the

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[75] Sumner, p. 327.

oligopolistic advantages enjoyed by the few who had already obtained charters. Moreover, by placing it in the position of being the only means by which others might enjoy a similarly advantageous position, the legislature became subject to all the pressures, devices, and currying of favor by any and all who wished a bank charter.[76]

Political Influence

The failure of the legislators to provide adequate enforcement provisions and the pressures surrounding the chartering function were not the only weaknesses in the charter system; political considerations did not cease to exist when the charter was granted. In numerous instances, the legislative body was unwilling to take appropriate action, even when it clearly had the authority, because the situations involved individuals of political prominence and influence.

An example is found in an incident at the Bank of the State of Tennessee, where early in 1830 the cashier was found to be about $80,000 short in his accounts. He was successful in his refusal to hand over the books of the bank because the shortage resulted from overdrafts by individuals whose identity he would not divulge. Reportedly, the bank had extended the overdraft privilege to the extent of $200,000 or $300,000 to "distinguished persons." In order to prevent the names of these individuals from being made public, the entire matter of the defalcation and the overdrafts was hushed up, and the cashier was not prosecuted. The only action that was taken appears to be a requirement by the legislature in December of 1831, almost two years later, that the president and

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[76] Bray Hammond, "Free Banks and Corporations: The New York Free Banking Act of 1838," Journal of Political Economy, University of Chicago Press, Chicago, Illinois, April 1936, pp. 187-188.

directors of the bank report the defalcation together with the names, amounts, and the then current balance of the overdrafts in question.[77]

An examination of the branch of the Bank of the State of Illinois at Shawneetown by commissioners appointed in 1824 for that specific purpose revealed some malfeasance. Various remedial measures were taken within the bank, including such things as accepting no further deposits and taking certain precautionary steps with respect to outstanding currency. An investigation initiated by the newly elected governor shortly thereafter confirmed that there had been mismanagement, but the truth was not brought to light and charges were not brought, apparently because the committee reporting on the charges was hand-selected by politicians under whose influence the bank was operated.[78]

The conflict-of-interest effects of political influence did not go unnoticed, of course, and various steps were taken over time to remedy the situation. Most seem to have been instituted in later periods; however, an earlier example is a provision in the 1838 constitution in Florida that removed banking at least one step from the potential influence of legislators. It provided that no individual, while he was a bank officer and for a year after he ceased to be a bank officer, could be eligible to be governor, senator, or representative for the State of Florida.[79]

It is readily apparent that, although bank charters provided a starting point, a foundation on which to build an effective bank supervisory system, they clearly were not without serious fault, both as to

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[77] Sumner, p. 151.

[78] Sumner, p. 159.

[79] Sumner, p. 318.

their own terms and provisions and as to the processes whereby they were acquired and implemented.

CHAPTER VI

SUBSTANTIVE IMPROVEMENTS INAUGURATED

Neither the public nor the legislatures could remain blind to the need for corrective measures. Each bank failure brought harm to people. Each scandal regarding bank operations brought unfavorable publicity. The public reaction was one of general antipathy and distrust toward banks. Various landmark steps were taken, some by bankers and entrepreneurs and some by legislators, to eliminate troublesome features and to make banking more safe.

Suffolk Bank System Developed

In older, more settled New England, banking had tended to become more restrained; nevertheless, the normal banking situation consisted of a miscellany of banks, each issuing its own currency. Notes drawn on banks in the country or elsewhere out of the area were termed "foreign" currency, and presented many problems. The situation was not unique; it existed in all parts of the nation. In dealing with this situation, Massachusetts arrived at a solution that represented a milestone in the development of the American banking system.

In the early 1800's, country money was circulating in such volume as to present a problem for Boston merchants. The Boston banks neither accepted these notes for deposit nor made any provision for redeeming them. The merchants found it necessary to accept currency of out-of-area banks in the course of their business, but encountered difficulty

in getting these notes redeemed. Some country banks either had refused to redeem them on presentation or had resorted to "all sorts of chicanery" to make redemption as difficult as possible.[80] The Boston banks, on the other hand, stood ready to redeem their own notes at any time.

The first development growing out of this situation was the widespread use of country bank notes as the circulating medium, coupled with the near disappearance of Boston bank notes. In fact, the Boston banks were encountering difficulty in keeping their currency issues afloat, because their attitude in refusing foreign notes stimulated the use of the very note issues they sought to ignore. Ultimately, the Boston banks were forced to adopt different policies, particularly as pressure was applied by the many merchants who also had financial interests in Boston banks.[81]

There were interim developments, one of which was a growth in the number of note-brokers who bought the currency of country banks at a discount, accumulated them, and then sent them to the issuing bank for redemption. Some brokers engaged in a reverse operation, accepting payment from the country banks to bring notes to be circulated in Boston. Another interim development was the organization of the New England Bank in 1813, which almost immediately established a policy of collecting country notes at cost, and soon was engaging in an extensive business of purchasing and collecting these foreign funds.[82] Eventually, some of the other banks followed suit, and it was out of this change in policy on the part of several of the banks that the Suffolk system emerged.

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[80] Fritz Redlich, The Molding of American Banking, Part I, 1781-1840, History of American Business Leaders, Vol. 2, Hafner Publishing Company, Inc., New York, 1947, p. 69.

[81] Redlich, p. 69.

[82] Redlich, p. 69.

The Suffolk Bank commenced operations in 1818, and by 1819 was competing with the New England Bank in the business of handling foreign money. The system this bank devised was in effect a clearing house and comprised the initial phase of the Suffolk system. In other words, rather than being forced to pay in specie, the country banks were permitted to settle for their own notes by exchanging them for those of other New England banks which they had received in the regular course of business. The notes circulated at par, rather than being subject to discount or exchange fee by note-brokers.[83]

The final phase of the Suffolk Bank system evolved over a period of time from its initiation in 1824 to its final form around 1837. The essence was a plan under which eight Boston banks, including Suffolk Bank, entered into an agreement whereby they would receive and pay the notes of only those banks that maintained a clearing account with the Suffolk group.[84] As a result, the notes of all members of the Suffolk system circulated freely and at par.

Attempts at a system of this general type had been made earlier, notably in New York, but none had been as well devised and none had been successful. Despite the fact that the Suffolk system was not perfect, it represented a vast improvement over the currency situation that existed previously.

In addition, banks were almost forced to join because those that were not members, even though they paid specie over their counters and

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[83] Redlich, p. 71.

[84] Redlich, p. 72.

were sound institutions, found their notes were discounted if they were not members of the system.[85]

New York General Banking Law

The next significant forward step was taken by New York in 1827 when it enacted a general banking law for the purpose of correcting banking abuses. Actually, indications of New York's assumption of a position of leadership in corrective measures appeared two years earlier when it granted the Commercial Bank of Albany a charter that went further than the usual such document, this time specifically stating the activities in which the bank might engage.[86] The purpose of so circumscribing the bank's powers was to prevent its entrance into functions felt not to be conducive to sound banking. This did not prove to be an isolated case; all bank charters thereafter spelled out the functions permitted.

The 1827 general banking law had much more significance for bank supervision, for this was the point at which the regulation of banks changed from the specific charter provisions deemed appropriate by a given legislature for the individual bank being chartered to general provisions applicable to all banks.

As applied in New York, the law was not an effective piece of legislation; no bank was chartered under it and it was not made applicable to existing banks. The importance of the law was the change in concept it represented and the expanded scope of its requirements and restrictions.

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[85] William Graham Sumner, "A History of Banking in the United States," A History of Banking in All the Leading Nations, Vol. I, Edited by the Editor of The Journal of Commerce and Commercial Bulletin, The Journal of Commerce and Commercial Bulletin, New York, 1896, p. 416.

[86] John R. Kirk, Jr., The Development of Bank Supervision in the United States, Federal Deposit Insurance Corporation, Washington, D. C., 1949, p. 6.

Among its provisions were measures concerning directors' duties and responsibilities aimed at preventing self-dealing and other related abuses, features protecting the bank's capital position, and various other provisions generally making this a stringent law.[87]

The New York Safety Fund Act

Another milestone development in the evolution of banking and bank supervision took place with the passage in 1829 of the Safety Fund Act in New York. There are several particularly noteworthy aspects to this legislation. First, it appears to be the first public recognition of the principle of governmental responsibility for the protection of bank creditors. Second, in fulfilling its protective purpose, the Act was responsible for the initial implementation of the principle of insurance in the field of banking. Third, it was responsible for an important step in the development of bank supervision through its establishment of a permanent bank supervisory body.[88]

It might be noted that there was another purpose underlying the Safety Fund Act. Among those who were instrumental in getting the idea translated into law were some individuals who were strongly opposed to the second Bank of the United States. They hoped that the Safety Fund idea would be adopted in all the other states, thereby creating a system of state banks safe enough to be acceptable to the Federal government as depositories for its funds, and thus obviating the need for a Federally chartered bank.[89]

Briefly, the legislation provided that existing banks desirous of joining, plus all banks chartered thereafter, would contribute a small

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[87] Kirk, p. 7.

[88] Redlich, p. 88.

[89] Redlich, p. 94.

amount out of dividends (0.5 per cent of capital), to create a general fund from which the debts of insolvent banks would be paid. Also included were provisions for liquidating insolvent banks by the chancery court, for limiting currency issues of a bank to double the amount of capital, and for limiting loans and discounts to 2-1/2 times capital.[90] Various other provisions placed limits on the maximum size of the fund and specified methods of reimbursing the fund for payments made on the liabilities of a failed bank.

The insurance feature of the Act, at the time the most innovative and newsworthy of its provisions, certainly was an important step in banking progress. Unfortunately, it was an imperfect vehicle as then conceived, and it did not provide the protection it seemed to promise. It apparently was the intent to protect holders of notes of banks that became insolvent; instead, the statutory language applied to all liabilities. Over time, the fund proved inadequate to cover the amounts, and the state ultimately had to float bond issues to replenish the depleted fund. Although the vehicle was somewhat imperfect, the fact that it was going in the right direction is evidenced by the eventual adoption of the theory in the form of the Federal Deposit Insurance Act almost one hundred years later.

An even more significant aspect of the Safety Fund Act as far as bank supervision is concerned was its provision for the appointment of bank commissioners with authority to examine the banks and to close any bank deemed to be insolvent. It has been shown that the idea of inspecting or examining was conceived and adopted earlier; however, a comparison

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[90] George Tucker, The Theory of Money and Banks Investigated, Charles C. Little and James Brown, Boston, 1839, p. 222.

of the examining provisions of the charters of the first and second Banks of the United States with those of the Safety Fund Act clearly reveals the extent to which the latter represented great progress in the field of bank supervision.

The New York statute called for the appointment of three commissioners, who were not only authorized but were required to inspect at least once every four months all the books, papers, notes, bonds or other debt instruments of every financial corporation. Moreover, they were to compare the actual records with the statements published by the banks, to determine the amount of specie on hand, and to take whatever steps they considered necessary to determine the actual condition of the banks and their ability to meet their obligations. A subsequent amendment authorized the commissioners to examine under oath the officers, employees, agents, and any other individual with respect to the affairs and condition of the bank.[91]

The Act greatly expanded the scope of the examinations and gave relatively strong powers of enforcement to the commissioners; it also established the principle of a separate, permanent, professional board of commissioners.[92] It had been the general practice in the past for the responsible governmental authority to appoint individuals or committees to make an examination if and when it was determined that such was necessary. There is no indication it had heretofore been contemplated that banks should be made subject to obligatory, periodic examinations.

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[91] Redlich, p. 93.

[92] Redlich, p. 92.

Another important principle established by the Act was the removal of the supervisory function from the direct and constant control of the legislature. Whereas previous examiners or committees had been selected by, and often from, the legislature, this bill contained provisions for the three commissioners to be appointed by different groups: one by governor and senate, one by banks in the city and in the southern portion of the state, and the remaining one by all other banks. Unfortunately, the law was changed in 1837 so the governor and senate acquired the right to appoint all three commissioners.[93] Thus, one of the better features of the Act was lost, and the appointments again became subject to political pressures. This change enhanced the possibility that commissioners would be appointed with less regard to their qualifications than to their political affiliation.

The first indication that the Safety Fund principle was considered in another state occurred in Massachusetts in 1830, when the idea was explored by the legislature. In 1831, Vermont enacted a bill that encompassed the insurance and examination features of the New York Act, and such differences as existed between the two pieces of legislation were minor. Michigan was the only other state actually to enact comparable legislation, although the idea was considered in other areas.[94]

Even the limited examination concept had not been, and was not yet to be, universally accepted. In 1837, some eight years after the New York statute was passed, two New Orleans banks refused to submit to any examination because the State of Louisiana owned none of their stock

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[93] Sumner, p. 236.

[94] Redlich, pp. 94-95.

and, inasmuch as it had no direct interest in the banks, in their opinion the state had no right to examine their books. A similar view is known to have been held by Robert Morris as early as 1786.[95]

The examining function gained in scope and acceptance as time passed. In New York, the posts of bank commissioners eventually were replaced by a single comptroller. The state established a Banking Department under the direction of a superintendent in 1851 when it was concluded that the duties of the comptroller were too much for one man.[96]

The Suffolk system, together with the New York general banking law and Safety Fund system, were in and of themselves important steps in the development of both banking and its supervision. They also comprised an important part of the base upon which later phases would build.

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[95] Redlich, p. 92.

[96] Sumner, p. 422.

CHAPTER VII

THE FREE BANKING CONCEPT

The concept of free banking was not American in origin nor was it a new concept when it was adopted in the United States. The idea of anyone being free to engage in the business of banking had been put into practice in Scotland prior to the 1760's, and both the idea and the Scottish system based on it were known in Europe as well as in the United States.[97]

Although the concept was known at least to those somewhat schooled in matters of finance, if not to the man in the street, it was not until the idea was considered in the light of the difficult problems and conditions that existed in America in the 1830's that the concept could be implemented on a major scale.

The conditions conducive to the adoption of the free banking concept in America included the great credit needs of the pioneers. Most of these people in the 1830's were debtors, trying to establish farms and to settle frontier towns with more hard work and enthusiasm than money. It was at this time in the 1830's that the great opposition by President Jackson and all who favored minimum Federal government and maximum States' rights finally was successful in terminating the second Bank of the United States.[98]

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[97] Fritz Redlich, The Molding of American Banking, Part I, 1781-1840, History of American Business Leaders, Vol. 2, Hafner Publishing Company, Inc., New York, 1947, p. 187.

[98] Redlich, p. 187.

Under these circumstances, it was only natural that the states would be flooded with requests for bank charters, and that the great demand for banks would make bank stock a highly desirable investment. Unscrupulous legislators seized upon the opportunity to line their pockets in return for the favor of voting for a given charter; others--although not necessarily using any dishonest or shady methods--welcomed the opportunity to further their political ambitions. Free banking, in circumstances such as these, seemed an obvious and simple answer.[99] It would stop the political favoritism and the advantage accruing to those who were granted charters.

First Legislative Attempt

Accordingly, a bill was introduced in New York in 1835 to repeal the earlier legislation that restrained all but corporations chartered as banks from engaging in banking. However, public clamor and the backing of a large portion of the legislators was not enough to prevail against those legislators who wanted to retain the more conservative, individually chartered, bank system and those who wanted retention of the system for selfish purposes. The proposed bill in 1835 in New York actually was not the first time free banking had been proposed and had failed passage. One branch of the New York legislature had enacted such a bill in 1810; a bill with free banking features was debated in the Maryland legislature in 1831.[100]

Despite the popular acclaim for the idea and the fact that it had been entertained previously by legislative bodies, this attempt to pass

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[99] Redlich, p. 187.

[100] Redlich, pp. 187-188.

a free banking law in New York was not successful. The missing element was the support of a well-organized political group. This support ultimately was forthcoming from the Equal Rights Party, popularly known at the time as the Loco-Focos. This group, originally the radical right wing portion of the Democratic Party, had broken away from the Party and at this point in time was actively opposing the Democrats.[101]

Only one more problem had to be solved prior to passage of a free banking bill in New York. This involved finding some means of guaranteeing that the soundness of the circulating medium would somehow be retained so there would not be a flood of worthless currency. The solution ultimately agreed upon was the use of government bonds as collateral for bank notes.[102]

Free Banking Theory Becomes Law

All obstacles now having been overcome, the proposed legislation became a reality. Certainly at the time of its enactment in 1838, the New York Free Banking Act was the most important single step toward what became the unique American banking system. Both the statutory language and the principles enunciated therein eventually were taken over by every state in the Union and by the Federal government.

In theory, free banking was a concept espoused by Jacksonian Democrats, a "mass of rugged individualists imbued with...the fierce spirit of enterprise," who sought not only the eradication of the hated Bank of the United States, but who also sought the emergence of a system whereby there would be a multitude of local banks owned by local individuals. "The popular movement of the time was toward the destruction of

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[101] Redlich, pp. 187-188.

[102] Redlich, p. 95.

centralization and the untrammeled exploitation of the continent under individualism and laissez faire."[103]

What could have had more appeal to a pioneer people than a banking system that removed banking from the influence of political intrigue and favoritism and made it like any other business enterprise.

> "...it made banking free to all alike, so that anyone could become a banker as easily as a grocer, barber, blacksmith, or farmer; and in fact, in some cases more easily, because, as the law was applied in many states in which it was adopted, banking became a business which could be conducted without capital."[104]

An interesting side issue emerges when one contemplates the fact that certain functions always have been considered to be the exclusive right of government. The coinage of money is one such right, and no government has ever delegated it to private enterprise. There must have been considerable controversy as to how free banking could be consistent with this. An individual could not coin a silver dollar without being subject to prosecution as a counterfeiter, yet he could start a bank and print paper that was the equivalent of, and even convertible to, a silver dollar. Both the power to coin money and to punish those who counterfeited it were constitutionally granted to the Federal government, but the free banking concept in a sense gave everyone the right to coin money. Because there had been a long-standing difference of opinion regarding the right of the Federal government to delegate monetary functions, even to the extent of chartering banks, the widespread adoption of free banking laws must have added fuel to the fire of controversy.

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[103] Bray Hammond, "Free Banks and Corporations: The New York Free Banking Act of 1838," Journal of Political Economy, University of Chicago Press, Chicago, Illinois, April 1936, p. 184.

[104] Louis A. Rufener, Money and Banking in the United States, Riverside Press, Cambridge, Massachusetts, 1938, p. 400.

Free Banking Theory in Operation

The alacrity with which the free banking principle became practice is illustrated well in the case of New York, where 134 free banks obtained charters between April of 1838 and year-end 1839.[105] That the concept was not well executed in practice is illustrated by the fact that most of these banks survived only a very short time. Nonetheless, the idea of free banking really took hold during the 1840's, particularly gaining favor with the states to the West.

Free banking theory ordinarily is discussed in terms of the legislation and subsequent litigation in New York; however, it is interesting to note that a free banking act actually had been adopted in Michigan in 1837, a year earlier than in New York.[106] Its reasoning and provisions were similar because most of those migrating to Michigan at the time were from western New York State. It was only natural that they would bring current thinking in New York regarding banking. Thus, the free banking law was enacted in the new area before it could wind its way through the snarls, confusion, and haggling surrounding it in the New York legislature.

Unfortunately, free banking got off to an inauspicious beginning in Michigan. Almost all of the more than 40 banks organized under the free banking statutes in Michigan failed before the law had been in effect for three years.[107] The details of operations of these banks reported by state banking commissioners have more the sound of fiction than of fact.

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[105] Redlich, p. 202.

[106] Hammond, p. 196.

[107] Hammond, p. 196.

A long history of litigation followed enactment of the free banking law in New York. In general, it revolved around the issue of whether the free banking associations were in fact corporate bodies. An interesting case arose out of this central issue. A man named DeBow was accused of possessing counterfeit notes of the Bank of Warsaw and of circulating these notes with the intent to defraud the bank. Convicted in a lower court, DeBow subsequently was cleared by the State Supreme Court on the basis that the legislation under which the Bank of Warsaw was organized was unconstitutional; hence, in the eyes of the law, there was no such thing as a Bank of Warsaw for DeBow to defraud. As a result of this finding, not only was DeBow found not guilty--although there seems to have been no question as to the actuality of his fraud--but approximately half the banks in New York no longer had any legal existence. It was not until the end of 1845 that the Free Banking Act and the banks established thereunder were finally upheld by the Court for the Correction of Errors to which the question had been brought as a last resort.[108]

As the free banking system became more widely known, it was copied in other states. With rare exception, the bills closely resembled the New York statute. New Jersey enacted such a law in 1850; Ohio, Illinois, and Massachusetts followed soon in 1851; and between 1852 and 1861 similar laws had been enacted in Indiana, Tennessee, Louisiana, Wisconsin, Mississippi, Iowa, Minnesota, Pennsylvania, and Kansas.[109] As noted earlier, the practices typified as wildcat in nature were not

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[108] Hammond, pp. 202-203.

[109] Redlich, p. 202.

implemented only by banks organized under free banking laws; chartered banks perpetrated their share of tricks, too.

Ineffectiveness of Supposed Safeguards

It is unfortunate that the good intentions underlying the requirement that a would-be bank pledge securities or other collateral against its note issues and other indebtedness proved not only ineffective, but--in the case of Michigan, for example--disastrous. The legislation failed to provide adequate safeguards, despite the difficulties that had been encountered well before the free banking law when organizers had commenced business with little or no specie and with the majority of capital stock being paid by their own promissory notes.

Under the laws as adopted, a bank could commence business when only 30 per cent of its capital was paid in. In Michigan particularly, real estate mortgages were pledged as required, but the appraisal was based on highly inflated, boom-time values, and 100 per cent of the appraisal was allowed in the pledge.[110] In addition, ways were found to circumvent various other restrictions and to evade examinations. Finally, the protection supposedly provided by liability clauses proved mythical when suits were brought under these clauses and the courts did not uphold the statutes.

The abuses and general ineffectiveness of the feature whereby the currency of free banks supposedly was fully collateraled overshadow the fact that this section of the law was intended to protect the public. It has significance in that it represents one more step in the transitions toward the highly regulated protective structure of bank supervision

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[110] Redlich, p. 203.

that exists today. Even more important, it is something of an anachronism in that it occurs in a bill that reflects the very essence of laissez-faire theory.

Due credit must be given the integrity of those who drew up the various free banking laws. The statutory requirements were intended to insure conservative operations in the note-issuing function and proper safeguards in the maintenance of adequate capital and specie reserve. The actual result in many cases, however, was the evil of wildcat banking. It again is emphasized that not all free banks can be included in the category of the wildcat bank; many banks under that system were operated in an honest and conservative manner. In New England, for example, sad experience brought better banking methods, although this generality in no way implies that this region had no poor banking practices. The exceptions, however, pointed up the contrast presented by most of the banking institutions of the South and West.

Passage of free banking laws not only opened the floodgates with respect to the number of banks but also as to the variety and laxity of the operations of a great many of them. The innovative spirit with which banks sought to circumvent sound practice and legal restraints infected chartered banks as well as free banks.

CHAPTER VIII

WILDCAT BANKING REACHES ITS PEAK

It was stated at the outset that research for this paper revealed that all the practices ordinarily attributed to wildcat banks actually had their origin in earlier periods. The era of unsound--and sometimes flagrantly corrupt--banking practices is not to be found only in the period usually thought of as the wildcat banking era, i.e., the time between enactment of free banking laws around 1838 and the National Bank Act in 1863. However, it is true that the 1838-1863 period brought forth some schemes and tricks and devices that are outstanding examples of unbelievably bad banking, if indeed the term banking can be applied to them at all. Banks that indulged in this sort of chicanery were thoroughgoing wildcats.

First, what did a thoroughgoing wildcat bank look like? Although some probably resembled the more usual bank edifice, those who practiced to a fine art the hiding of the so-called bank to prevent anyone from being able to present its currency for redemption needed nothing so elaborate. With his newly printed bank notes in hand, the wildcat banker's objective was to circulate the notes in an area so distant as to make their presentation at the bank as difficult and inconvenient as possible.

An early pioneer gave the following picturesque description of a wildcat bank:

> "I visited one of these banks once. It was in a logging camp in the thick woods near the east shore of Lake Michigan. It was about eight feet square, eight feet high, made of rough boards, flat roof, with one small sliding window, a plain board shelf, on which the notes were signed, a small door, over which, in red chalk, was the name of the bank. It was never occupied but once. When I saw it, the bank had closed."[111]

That this was not an isolated instance is confirmed by the number of different references found on this typical trick of the wildcat banker. One such reference states that many of these banks were placed

> "...in the northern wilderness, where white men seldom trod and only an Indian guide could find. In some instances they were located within an Indian reservation, and had but a shanty for a bank. This condition could not long continue unmolested. The discount on the notes depended upon the 'get-at-able' location of the bank. The notes being redeemable in gold, were picked up, assorted, and the so-called 'carpet-bagger' sent out by the brokers to demand the coin, provided he could find the bank. Sometimes, when coming too near, a woodsman on the watch would meet him, and by intimidation or threat the hunter for coin would retrace his steps without venturing to make his demand."[112]

The Original Carpet-Baggers

The term "carpet-bagger" in the above quotation is being used in its earliest sense. Various terms were applied to practices of banks in their attempts to evade redemption of their notes in specie; "saddle-bag" or "carpet-bag" banks were among them. It was only later that the term carpet-bagger came to be applied to a Northerner seeking office in the South in Reconstruction days.

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[111] Andrews, Pioneers of Polk County, Iowa, Vol. I, p. 57 (as cited in Howard H. Preston, History of Banking in Iowa, The State Historical Society of Iowa, Iowa City, Iowa, 1922, p. 59.)

[112] John Jay Knox, A History of Banking in the United States, New York, 1903, p. 747 (as cited in William H. Dillistin, Bank Note Reporters and Counterfeit Detectors, 1826-1866, The American Numismatic Society, New York, 1949, pp. 60-61.)

The practice of sending a man to another state with a satchel full of notes to circulate became widespread. In some cases, circulation was accomplished through the purchase of some livestock or commodity that could be resold at home at a profit. In other cases, the circulation consisted of making a deal with the carpet-bagger from another bank.

> "For instance: The Frogtown bank, for I am told there were banks located occasionally in almost impenetrable swamps, and in those days, you must remember, there were no telegraphs and but few railroads--the fellow from Frogtown would get way out into Skunktown, another almost inaccessible place, and he would effect an exchange of ten, twenty, or thirty thousand dollars of Frogtown bank notes for a like amount of Skunktown bank notes, and the Skunktown bankers would put off the Frogtown notes on their customers, and the Frogtown bankers would put off the Skunktown bank notes on theirs, and thus they would go on with this legitimate business to their common advantage. ...the notes put in circulation in Skunktown couldn't find their way back to Frogtown, because the people in Skunktown didn't know where Frogtown was, and the people in Frogtown didn't know where Skunktown was, and if they did they couldn't get there; the people in one place couldn't get to the other to get the specie on which the notes were based. Then after the bank at Frogtown had paid out the Skunktown notes, the bank at Frogtown would refuse to receive the Skunktown notes, but it would send the holder, who was its debtor, around the corner to a broker, who would buy them at seven or nine per cent discount and then the broker and the bank would divide the proceeds of this gold basis transaction. That is a specimen of what was going on all over the country."[113]

Operations of this sort were not restricted to the western tier of states, but were carried out in other areas as well. A bank examiner commented that there was no bit of news more annoying to a North Carolina banker than that "a stranger was in town with a suspicious-looking carpet-bag in his hand; for it generally contained a bag full of notes of his bank for redemption...."[114] This is not to say that North Carolina banks

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[113] William A. Berkey, The Money Question. The Legal Tender Paper Money System of the United States, 2d ed., Hart, Grand Rapids, 1878, pp. 151-152 (as cited in Dillistin, pp. 63-64.)

[114] The American Banker, New York, June 21, 1899, p. 1095 (as cited in Dillistin, pp. 64-65.)

were wildcat banks, but it shows they were no more anxious to have their circulation returned than were any other banks.

There should be no implication that these banks, even in their inaccessible locations, were intended to have any degree of permanency. The fly-by-night characteristics of some pseudo-bankers was explained by the Governor of Indiana in 1852, when that State passed its free banking law:

> "The speculator comes to Indianapolis...with a bundle of bank notes in one hand and his stock in the other. In twenty-four hours he is on his way to some distant part of the Union to circulate what he calls a legal currency, authorized by the Legislature of the State of Indiana. He has nominally located his bank in some distant part of the State, difficult of access, where he knows that no banking facilities are required, and intends that his notes shall go into the hands of persons who will have no means of demanding their redemption."[115]

One feature in a law enacted in Indiana in 1855 well may have been inserted as a means of precluding use of the device of making the bank inaccessible and unidentifiable. The new statutes called for each bank to be identified by a sign, to actually be possessed of banking quarters, and to remain open for business from 10 to 3 on all business days. Moreover, the new law required each bank to have an agent at Indianapolis to redeem its notes.[116]

Bank Capital and Specie Reserves

Wildcat bankers exhibited little concern over their lack of capital, even in the face of state law requirements regarding a minimum specie reserve. As one writer aptly phrased it, "they were richer in

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[115] William Graham Sumner, "A History of Banking in the United States," A History of Banking in All the Leading Nations, Vol. I, Edited by the Editor of The Journal of Commerce and Commercial Bulletin, The Journal of Commerce and Commercial Bulletin, New York, 1896, p. 444.

[116] Sumner, p. 445.

psychological resources than in more tangible economic resources."[117] One evasive tactic involved a bank's acceptance of its own currency in payment for its capital stock. This method was deemed to meet the provisions of the law stating that stock was to be purchased with cash. Another tactic consisted of payment of only a part of the bank's capital, with the stockholders immediately borrowing the entire amount they had just paid. In situations such as this, the only way the bank could obtain specie with which to redeem its notes would be from its borrowers, who, either voluntarily or by requirement, would repay loans in specie rather than in bank notes.[118]

It is impossible to determine the portion of total bank capital attributable to wildcat banks, but both these and the more conservative banks in the West were prone to be short of capital in this developing stage. The effect of the greater relative need, together with the procedures used by both wildcat and legitimate banking operations is evidenced by the following figures. As of 1860, gold and silver coinage held by Illinois banks was equal to only about 4.25 per cent of their currency and deposits; specie held by New York and Massachusetts banks was equal to 20.4 per cent and 21.6 per cent, respectively. The percentage held by Louisiana banks was 52.5 per cent.[119] The Louisiana figure seems surprisingly large; however, there are two factors that must have contributed to its very favorable position. First the State had enacted a banking bill considered one of the best in the nation, and

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[117] Louis A. Rufener, Money and Banking in the United States, Riverside Press, Cambridge, Massachusetts, 1938, p. 401.

[118] Rufener, p. 397.

[119] Charles J. Bullock, Essays on the Monetary History of the United States, The Macmillan Company, New York, 1900, p. 93.

second, the importance of New Orleans as a trade and distribution center tended to make it a net receiver of specie.

Bankers of wildcat persuasion found ways to use specie that were more advantageous to them than holding it as a reserve. A particular group of North Carolina banks made it mandatory that borrowers accept their loan proceeds in bank notes, which were circulating at less than face value, and repay the loans in specie. The banks then used this specie to purchase their own notes at the discounted price, thus making a profit both from the interest on the loan and the subsequent currency purchase.[120] The lure of the profit on the latter transaction overcame any more conservative impulse to retain this specie as a reserve for the redemption of outstanding currency.

The promoter of a particular wildcat bank wrote to a correspondent bank to arrange for funds to be on hand in accordance with legal requirements. Rather than seeking to obtain specie, he proposed that a certificate of deposit be given to the new bank so the required report of specie of the correspondent bank need not be altered and, at the same time, the new bank could claim the same specie as supporting its capital stock and subsequent note issue.[121]

A cash reserve fund that circulated from bank to bank was a favorite means of Michigan banks with which to deceive the state bank inspectors. The state inspector found a cash reserve in each of these banks, the single fund having been spirited through the forests by night to be on hand when he arrived at the next bank to be inspected.[122]

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[120] Rufener, p. 397.

[121] Carter H. Golembe, State Banks and the Economic Development of the West, 1830-1844, Columbia University, 1952, p. 20.

[122] Rufener, p. 401.

It has been stressed that the wildcat practices were not limited to the West in general or to Michigan in particular; however, Michigan had its share and more of wildcat banks, and every devious or unsavory banking practice that was found elsewhere, also was found in Michigan. This may be attributable in large part to the State's free banking law, which was based on that of New York, but which was so loosely drawn that it was more a caricature than a copy of the New York legislation.

As in the New York statute, one of the provisions of the Michigan law was for the appointment of bank commissioners. Their first report, submitted in April of 1838, revealed a number of the practices that characterized the institutions organized under the loose terms of the statute. The commissioners found with respect to one particular institution:

> "On examination of the books of the Jackson County Bank, the following circumstances were exhibited: the names of all persons and corporations with whom accounts had been opened were written in pencil; the entries in ink. In a few minutes, therefore, the whole face of the business transactions of the bank could have at any time been entirely changed.
>
> "The Commissioners proceeded to an examination of the specie of the bank. Gold coin was exhibited loose in a drawer, which, being counted, amounted to the sum of $1,037.78; about $150 in loose silver was also counted. Beneath the counter of the bank, nine boxes were pointed out by the teller as containing $1,000 each. The teller selected one of these boxes and opened it; this was examined, and appeared to be a full box of American half dollars. One of the Commissioners then selected a box, which he opened, and found the same to contain a superficies only of silver, while the remaining portion consisted of lead and ten-penny nails. The Commissioner then proceeded to open the remaining seven boxes; they presented the same contents precisely, with a single exception, in which the substratum was window-glass broken into small pieces."[123]

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[123] Sumner, pp. 329-330.

The commissioners noted that, according to the bank's statement of three days prior to their examination, the Jackson County Bank stated it was in possession of $20,000 in specie and a certificate of deposit for an additional $10,000.

In many areas, free banks were required to pledge bonds as security for bank notes issued, such issues thereby being limited to the value of the bonds pledged. The intention was to prevent unlimited floods of paper money. Instead, the result was the practice known as "shingling." i.e., the banks pledged bonds, issued currency, bought bonds with the currency, pledged these, issued more currency, and so on. It readily can be seen that from a very small actual investment, the banks were in a position to reap large profits from the interest received on these various bonds purchased. The same kind of operation could be employed with other securities.

Two examples of this type of shingling or pyramiding show the extent to which the practice could be followed and, in the case of the banks, the extent of the damage that could follow when the house of cards toppled. Before 1857, 51 of the 94 banks established since enactment of Indiana's free banking law in 1852 had failed. "These banks had been built one upon another, the notes of one being used to buy the stock with which to organize another."[124] The other case involves a man

> "...who bought bonds with notes, deposited the bonds for circulation; with the notes bought more bonds, and repeated the process. With $10,000 capital, he got out, before 1857, $600,000 of circulation; he did no banking, but lived on the interest of his bonds."[125]

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[124] Sumner, p. 445.

[125] Sumner, p. 445.

Loan Abuses

Some of the practices regarding loans appear more unsound in the light of current lending methods and theories than when viewed in the environment of their own time. The thinking of past decades certainly influenced the credit principles of the free banking period. Although there is ample evidence that operations of a wildcat type more often than not were deliberate, there appears to be some merit to the view that some of the loans were unsound because of other factors.

To a great degree, the unsound banking of the day can be attributed to honest error and to blind following of tradition. In the late 1820's and 1830's, there was a genuine attempt to make banking sound. Corrective efforts were directed toward preventing the over-issuance of notes, the failure to redeem notes in specie, the failure to provide adequate security against note issues, and various other unsafe or fraudulent practices.[126]

The measures adopted were effective to a degree in countering many of the reckless or dishonest operations, but were not effective against illiquidity. It seems at first surprising that the malady of illiquidity affected banking in a period supposedly addicted to the old commercial banking principle which held that bank loans should be short-term and self-liquidating.

Many of the wildcat banks engaged in the practice of making excessive numbers of long-term loans secured by mortgages.[127] The more

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[126] Fritz Redlich, The Molding of American Banking, Part I, 1781-1840, History of American Business Leaders, Vol. 2, Hafner Publishing Company, Inc., New York, 1947, p. 44.

[127] Bullock, p. 93.

serious problem surrounded the widespread practice of granting "accommodation loans." This was the term applied to promissory notes that "were medium or long-term loans, disguised under the form of two or three-month notes."[128] As in the past, there was no recognition in the free banking era that industrial credit was a type unto itself. There were no intermediate-term or long-term loans per se. Thus, 90-day accommodation paper could be used to build ships and steamers as well as mills and breweries and distilleries because the borrowers were assured of being granted renewals when their notes were due.[129]

With a large portion of the bank's liabilities payable on demand, it should have been obvious that loans that were essentially long-term, could not possibly be liquidated in sufficient volume and in sufficient time to prevent bank failure when customer demand exceeded the small amount of cash held by the bank. Nevertheless, this practice was not infrequent, and the lesson apparently was not easily learned.

The nature of the loan was not the sole cause of the various abuses of the lending function perpetrated by wildcat banks. One frequently found abuse surrounded the mechanics of the lending function, and involved the actions of the bank's directors.

> "While average directors of leading Eastern city banks probably lived up to the ethical standards of other businessmen of their time and of their section of the country, the morals of the average country bank directors were notoriously low. They preempted the credit facilities of the bank which they controlled and in addition were supposed very often to have used their position for dubious private gain."[130]

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[128] Redlich, p. 11.

[129] Redlich, p. 47.

[130] Redlich, p. 56.

Directors of wildcat banks almost certainly would be found among the latter group.

The position of the directors at this stage of banking was one of considerable influence and authority. They were not paid for their services; hence, were perhaps even more subject to the temptation of being compensated in some way for the use of their valuable time. Some self-favors were relatively minor, such as granting themselves lines of credit. Others, such as granting favors or withholding approval of a worthwhile credit on some personal grounds were much more serious and much less simply controlled. In some cases, a fee--more accurately, a bribe--was required in order to get director approval of a loan. In other cases, approval of a large portion--often 30 to 50 per cent--of the bank's total loan portfolio was assured because it consisted of loans to the directors and their interests. An excellent illustration of the self-serving nature of some banks is revealed in the case of Rhode Island, which reportedly in 1826 had 43 banks--a ratio of more than one bank to each 2,000 population. Approximately one-third of the total capital of these banks had been loaned to directors and other stockholders.[131] While this particular case predates the free banking period, other subsequent examples confirm the fact that such practices continued, and that a great many banks were created solely for the benefit of their organizers and directors.

Irredeemable Paper Floods the Market Place

The very essence of the thoroughgoing wildcat bank was its issuance of irredeemable currency. The reason, of course, was that it had little or no precious metal. Evidencing the impossibility of redemption is an

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[131] Sumner, p. 170.

example cited wherein one of the notorious banks that failed in the very early days of wildcat banking was found to have in its specie reserve $86.46 for the redemption of $580,000 in notes outstanding.[132]

Locating the bank in an inaccessible place to prevent demand for redemption was an extreme measure. The practicioner of wildcat banking had numerous less extreme but quite effective ways of accomplishing the same result. One of the devices so employed was the issuance of currency that had all the appearances of other currency which was convertible to gold or silver upon presentation of the note at the drawee bank. These notes had one major difference: they were not payable on demand, but rather at some future time, often being somewhere between three and twelve months from the date of issuance.[133] These notes were called "post notes" and were viewed with suspicion; their very postdated nature suggested--and rightly so--that the issuing bank was overextending itself.

Time was the great ally of wildcat banking, and was used to full advantage whenever possible. Redemption of currency on demand was not always refused, but sometimes could be handled in a manner hardly within the spirit of the law. Such a case occurred in 1859 when two packages of bank notes, each containing $500, were presented to Reapers' Bank in Illinois. The bank refused to redeem the entire sum at once; instead it spent more than a full banking day on each of the two packages, paying out in dimes and half dimes on one note at a time. In a subsequent court action, the bank's tactics were characterized as "improper, and unwarranted, and not a compliance with its lawful duty."[134] This finding must

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[132] Bullock, p. 84.

[133] Dillistin, p. 69.

[134] Sumner, p. 448.

have gladdened the heart of the plaintiff, but could not remedy the inconvenience suffered. The number of cases involving similar delaying tactics lies within the realm of conjecture, but this incident probably was not unique.

A more sophisticated procedure for delaying the redemption of notes in specie was practiced by two banks in New Jersey in 1851. These banks engaged in a practice on the order of the modern device of kiting. Two Wall Street banks designated Tom's River--70 miles and about a day's travel from New York--as the point of issue for their currency. At that time, Tom's River was a village comprised of four stores, one public house, and two banks. The presidents of the two banks were landlords of the public house and keeper of the dry-goods store, respectively.[135]

While allegedly issued at these two banks in New Jersey, the notes of the two Wall Street banks actually were issued in Wall Street, and generally were circulated by selling them to brokers at a discount. In order to present the notes for payment, an individual had to travel from New York to Tom's River, a journey that took from early morning until well after the banks had closed for the day. There was no alternative but to wait until the next day, missing the morning train back to New York, in order to present the notes for payment. It was then necessary to stay over still another day to get the morning train, arriving back in New York in the evening of the third day.[136]

The above procedure was operative only if the local bank redeemed the notes in specie on demand. Under the provisions of New Jersey law, banks had a three-day grace period for redemption after the demand had

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[135] Dillistin, p. 76.

[136] Dillistin, p. 76.

been made. Thus, the banks could send to New York for specie to cover payment of any large amount of bills that were presented to them, further extending the total delay. Reportedly, neither of the banks commented on above survived for more than three or four years.[137]

Variations on Currency and Coin

It is not difficult to imagine the low esteem in which the public held the notes of banks that had wildcat traits. Yet it was impossible to transact business without some medium of exchange, so a number of variations and substitutes freely circulated and were accepted as currency, although they often were equally irredeemable and often were not even issued by banks.

Largely, an insufficient volume of small coins was responsible for coin substitutes. Despite the fact that there was a local bank in the town of Madison, Indiana, at the time, local merchants issued "shinplasters," which were paper notes, in small denominations--50 cents, 25 cents, 12-1/2 cents, and 6-1/4 cents--used for making change.[138]

Motives other than a shortage of small denominations are attributed to some bankers and others who circulated this so-called currency. Some of the fractional notes were redeemable only when accumulated in a stipulated amount, such as five dollars.

> "Notes were issued in such small denominations as one shilling, or even five cents, in the expectation that it would never be worth any one's while to collect such infinitesimal currency and present it for redemption."[139]

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[137] Dillistin, pp. 76-77.

[138] Logan Esarey, State Banking in Indiana 1814-1873, Indiana University, 1912.

[139] Bullock, p. 93.

The derivation of the term shin-plaster is an interesting incidental. It was a name commonly applied to paper money, particularly that which had lost some of its stated value, and was popularly used for notes of less than one dollar. Reportedly, the term came into use during the Revolutionary War when an old soldier who held a quantity of the then nearly worthless Continental currency "very philosophically used it to bandage a wounded leg."[140]

Currency sometimes was known by derogatory terms other than wildcat, often with geographic implications. "Wildcat" tended to be applied primarily to Michigan currency. However, a banker from the West in discussing the advantages of a uniform currency, linked shin-plasters with Michigan; wildcats with Georgia, Canada, and Pennsylvania; red dogs with Indiana and Nebraska; rags with North Carolina, Kentucky, Missouri, and Virginia; and stump-tail with Illinois and Wisconsin.[141]

The "stump-tail currency" appears either to have had a later origin or to have acquired a particular significance that did not necessarily apply to others. While it was just as irredeemable, it was used around the time of the Civil War to designate notes of those banks that had pledged bonds of southern states as security for their currency. These bonds dropped in value over time, and became worthless as soon as the War started; thus, their note issues were reduced to the point of being but a "stump."[142]

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[140] Dillistin, p. 66.

[141] Dillistin, p. 73.

[142] Dillistin, p. 140.

CHAPTER IX

THE SEARCH FOR REMEDIAL MEASURES

Note Brokers

With the multiplication of banks, each issuing its own notes, the normal course of trade forced individuals to deal in assorted currencies. So long as the currency was of a local bank in which people had confidence, the notes could be accepted freely and without hesitation. However, when notes that were changing hands were those issued by banks at points too distant to be known by the tradesmen, there was doubt as to their worth.

Particularly in the West in the free banking era, much of the currency in circulation was irredeemable, unstable, and consequently unpopular. With worthless currency circulating along with par currency, it was impossible for the layman to discriminate between the good and the valueless.[143]

It was said of the situation that "different States were as to their bank notes so many foreign nations, each refusing the paper of the other, except at continually varying rates of discount."[144]

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[143] Roger B. West, A Bankers' FDIC Handbook, Graduate School of Banking, Rutgers University, 1953, p. 7.

[144] Senator Sherman, speech delivered in U. S. Senate, February 1863 (as cited in Andrew McFarland Davis, The Origin of the National Banking System, National Monetary Commission, Washington, 1910, p. 16.)

In addition to needing some idea of the solvency of the particular bank whose notes were being offered, there also was a need for some means of converting the notes to specie or--on occasion--to bank deposits.

Out of this situation grew the business of brokers. These men, particularly in the larger population centers, engaged in purchasing and subsequently in arranging for redemption of notes drawn on out-of-area banks. In order to perform this function, the brokers also had to ascertain the value and establish a price at which they would handle the out-of-area bank notes. Quite aside from the price effect of the issuing bank's reputation, there was the consideration of the broker's expenses in connection with redemption, together with his normal profit. Consequently, broker's transactions were always at some discount, established by the broker on the basis of the factors noted above.[145]

Eventually, the volume of such business and the amount of public interest was such as to warrant publication of lists in the newspapers in the more important trade centers. The lists specified the discount rate at which brokers would purchase the currency of named out-of-area banks. It is interesting to note that a number of brokers expanded their scope of operations to include the selling of lottery tickets. While the reason for combining these two functions probably was based on practical considerations, one cannot help but be aware of the similarity of certain characteristics common to both lottery tickets and bank notes of that day.

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[145] William H. Dillistin, Bank Note Reporters and Counterfeit Detectors, 1826-1866, The American Numismatic Society, New York, 1949, p. 1.

The first known bank note broker was Jacob Reed, Jr., who advertised his New York Commission and Brokerage business in 1786, indicating that he would redeem Philadelphia bank notes in cash at a moderate discount. Advertisements in newspapers of the period indicate a growing number of bank-note brokers over the years.[146]

Bank Note Reporters

It was a natural transition to expand into the publication of additional information with respect to bank notes and to include data essential to merchants, who were faced with making a decision every time a piece of currency of a nonlocal bank was presented. This information was a report on the current discount of the bank notes, a list of banks whose notes were being counterfeited, and a detailed description of the counterfeit notes as a means of identifying them. The counterfeits included notes that were altered as to amount or issuing bank, notes of nonexistent banks, or notes with forged signatures.[147]

In late 1805, the number of bogus bank notes in circulation had increased to such an extent that Messrs. Gilbert and Dean, who published a newspaper, issued a separate sheet on which they described counterfeit notes. This appears to be the earliest form of separate counterfeit detector. It was so well received and so needed at the time that they later published an enlarged version in pamphlet form. Although they issued a postscript updating the pamphlet, there is no indication that they continued the practice.[148] It was not until about 20 years later

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[146] Dillistin, pp. 1-2.

[147] Dillistin, p. 3.

[148] Dillistin, pp. 25-26.

that a counterfeit detector was put into general circulation. The combination of discount information and counterfeit description became a regularly published periodical in about 1826.[149]

As might be expected, with the proliferation of bank note reporters and counterfeit detectors there also came the opportunity for dishonest publishers to accept bribes from banks to quote their money at a higher rate than it warranted. The practice was referred to as "puffing up," and the reverse, that is, quoting it at a lower price, was referred to as "blowing" a bank.[150]

An example of an extreme case of puffing up took place in Ohio in 1859, when a bank was organized by the expenditure of $165 for a plate from which to print currency. Satisfactory credit rating was then guaranteed by the publisher of a bank-note detector, who agreed to list the currency as acceptable in return for a "gift" of $1,900.[151]

As the number of bank note reporters expanded, competition among their publishers was considerably enhanced, and it was not at all unusual for the publisher to include in his reports some highly critical remarks about his competitors. In many cases, the remarks bordered on libel.[152]

One publisher, commenting on the activities of another whose business had just failed, openly named five banks in Rhode Island as those that had been favorably quoted and "puffed" by his competitor and

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[149] Dillistin, p. 41.

[150] Dillistin, pp. 47-58.

[151] Charles J. Bullock, Essays on the Monetary History of the United States, The Macmillan Company, New York, 1900, p. 92.

[152] Dillistin, p. 95.

which now were deprived of his paternalistic concern. He said of them: "It makes no difference in what 'Reporter' you may see them favorably quoted and 'puffed,' do not be rash and retire to bed with any of their notes in your pockets." He urged his subscribers to have nothing to do with Eastern money unless they knew it to be sound and amply secured.[153]

The value of the bank note reporters and counterfeit detectors is indicated by the following statistics:

> "In 1862 there were fifteen hundred banks, the notes of 253 of which had not been counterfeited. The variety of imitations was 1,861; of alterations, 3,039; of spurious notes 1,685. From 1853 to 1862 the Association for the Prevention of Counterfeiting at Boston caused 434 persons to be sent to State prison for an aggregate time of 1,425 years, four months."[154]

One authority on banking of the period commented rather bitterly on bank note detectors and the unfortunate circumstances that made such a device necessary:

> "The Bank Note Detector did not become divested of its useful but contemptible function until the national bank system was founded....The 'bank notes' were bits of paper recognizable as a species by shape, color, size, and engraved work. Any piece of paper which had these appearances came with the prestige of money....The person to whom one of them was offered, if unskilled in trade and banking, had little choice but to take it. A merchant turned to his 'Detector.' He scrutinized the worn and dirty scrap for two or three minutes, regarding it as more probably 'good' if it was worn and dirty than if it was clean, because those features were proof of long and successful circulation. He turned it up to the light and looked through it, because it was the custom of the banks to file the notes on slender pins which made holes through them. If there were many such holes the note had been often in bank and its genuineness was ratified. All the delay and trouble of these operations were so much deduction from the character of the notes as current cash. A

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[153] Dillistin, p. 88.

[154] William Graham Sumner, "A History of Banking in the United States," A History of Banking In All the Leading Nations, Vol. I, Edited by the Editor of The Journal of Commerce and Commercial Bulletin, The Journal of Commerce and Commercial Bulletin, New York, 1896, p. 455.

community forced to do its business in that way had no money. It was deprived of the advantages of money. We would expect that a free, self-governing, and, at times, obstreperous, people would have refused and rejected these notes with scorn, and would have made their circulation impossible, but the American people did not. They treated the system with toleration and respect. A parallel to the state of things which existed, even in New England, will be sought in vain in the history of currency."[155]

Protective Devices Contaminated

Some differentiation should be made between the honest note brokers and those who used the opportunity to gouge the public. For instance, an individual need not have been in possession of the notes of nonlocal banks in order to have been subjected to a discount from their face value. Local storekeepers and merchants also took advantage of the situation on occasion and charged a discount, even though the notes of that particular bank were circulating at par and were fully redeemable by the merchant without loss. Those most likely to be subjected to this unnecessary loss of purchasing power, then as now, were those unschooled in the ways of banking and those least able to afford the loss.

The procedure whereby the notes of one area had to be exchanged for the notes of another as one went further from the first area and approached the second, almost without fail resulted in a loss of value through discounting. This practice was popularly referred to as "shaving." The brokers who engaged in this were known as "shavers" and were not usually those who were performing a necessary service, but were opportunists seeking high profits.

A traveler in late 1817 commented that gold or silver coin was rarely seen, and that the coinage one encountered was comprised primarily

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[155] [illegible], p. 455.

of cut Spanish dollars; the cut pieces--referred to as bits--were for 12-1/2 cents, 25 cents, or 50 cents. At the same time, it was quite usual to find paper notes for small amounts, ranging from 3-1/4 cents to 2 shillings 2 pence. He noted that bank notes had varying rates of discount, ranging as high as 40 per cent, with the rate based not on lack of faith in the bank or on its relative strength, but merely on the factor of distance. Contemplating this, he concluded he probably could have covered his expenses had he been aware of this "shaving" practice in advance. He could have bought at a discount in each town the notes of a bank at the next town to which he was going; the notes would have been convertible at par when he got there.[156] Most travelers were probably similarly unaware that the discounting practice could have been turned to their advantage.

John Calhoun, then representing South Carolina in the United States Senate, received a letter from a traveler who recounted his experiences. This man, probably a typical traveler, reveals the nuisance and amount of necessary exchanging of bills, the loss that attended it, and the variety of paper received in some of the exchanges. He wrote in the condensed journal of his journey:

> "Started from Virginia with Virginia money--reached the Ohio River--exchanged $20 Virginia note for shin-plasters and a $3 note of the Bank of West Union--paid away the $3 note for breakfast--reached Tennessee--received a $100 Tennessee note--went back to Kentucky--forced there to exchange the Tennessee note for $88 of Kentucky money--started home with Kentucky money. In Virginia and Maryland compelled, in order to get along, to deposit five times the amount due, and several times detained to be shaved at an enormous per cent. At Maysville, wanted Virginia money--couldn't get it. At Wheeling, exchanged $50 note Kentucky money, for notes

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[156] Dillistin, p. 5.

of the North Western Bank of Virginia--reached Fredericktown--there neither Virginia nor Kentucky money current--paid a $5 Wheeling note for breakfast and dinner--received in change two one dollar notes of some Pennsylvania bank, one dollar Baltimore and Ohio Rail Road, and balance in Good Intent shin-plasters--one hundred yards from tavern door, all the notes refused except the Baltimore and Ohio Rail Road--Reached Harper's Ferry--notes of North Western Bank in worse repute there than in Maryland--deposited $10 in hands of agent--in this way reached Winchester--detained there two days in getting shaved--Kentucky money at 12 per cent., and North Western Bank at 10."[157]

Among notorious shavers was Vincennes Bank, where shaving was accomplished by agents it reportedly stationed in communities on the eastern border of Indiana. Their function was to exchange notes of its branches for eastern bank notes. Inasmuch as the notes of the branches of the Vincennes Bank were depreciated substantially, the holder found he had to suffer a heavy discount on this paper, which he had taken at par in return for his good money. The practice was particularly prevalent in connection with land sales, so the amounts involved were meaningfully large to the would-be settler. While Vincennes Bank was not the only note shaver, it was numbered among the worst of this type of bank.[158]

Another aspect of the sale of bank notes at a discount was the opportunity this provided a bank to purchase its own notes at an amount less than the par value it would have to pay were these notes presented for redemption. In Maryland, for example, various banks made arrangements for agents to travel about for the purpose of buying up at a discount their notes from brokers, with whom the plan had been devised in advance.

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[157] Dillistin, pp. 44-45.

[158] Logan Esarey, State Banking in Indiana 1814-1873, Indiana University, 1912, p. 233.

In an attempt to stop this practice, Maryland enacted a law that made it illegal after 1818 for any person to engage in any transaction with notes of a Maryland bank in an amount less than their face value or to employ a broker or agent to do so. However, the law did not serve the purpose intended but rather served to increase the amount of discount to compensate for the added risk involved.[159]

Subsequently, Maryland authorized the licensing of note brokers; however, the almost continuous battle against the brokers and shavers began again in 1841 when the license fee was raised to an annual $3,000. At the same time, the penalty for operating without a license was set at $500 per offense, and the banks were relieved of the requirement to redeem their notes in specie if the presentation was made by a broker. The state relented in the following year, reducing the license fee to $50, because a great mass of nonpar paper currency had accumulated, particularly notes of out-of-state banks, the sale or exchange of which could be accomplished only through brokers.[160]

The Maryland experience would appear to substantiate the fact that the legitimate brokers served a highly useful purpose. The heavy-handed legislation--although intended to correct an unsavory means of banks making an additional profit on their own currency--did not actually represent a step forward in good bank supervision. For one thing, the law appears to have been unenforceable; in addition, its scope was so broad as to prevent the necessary intermediary function performed by brokers.

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[159] Alfred Cookman Bryan, "History of State Banking in Maryland," Johns Hopkins University Studies in Historical and Political Science, Herbert B. Adams, Editor, The Johns Hopkins Press, Baltimore, January 1899, p. 68.

[160] Bryan, pp. 108-109.

In the final analysis, the legislation brought greater inconvenience and risk than the undesirable practice it sought to prevent.

The reader is invited to examine the currency and currency variations reproduced at the end of this paper (EXHIBITS, pages 106-110). In addition to bank notes, the items include fractional denominations issued by storekeepers and others. One note is for six-and-a-quarter cents, payable in rum. This piece of paper, issued in 1839 by Vauxhall Drinking Institution, while not actually possessing the characteristics of money, probably circulated as small coin. Several of the exhibits illustrate the device of not redeeming notes individually, but converting them only after a stipulated dollar amount was accumulated. Even then, most promised payment not in specie, but in other paper, such as "Virginia Money" or "Current Notes." Although the items exhibited are limited in number and variety, all were issued during the wildcat banking era, and they give at least an idea of the "money" one might have encountered in Washington, D. C., where this particular group was found. They exemplify the problems an individual might encounter in normal cash transactions, and also indicate the value of a note broker in accumulating and redeeming the various items.

CHAPTER X

PUBLIC REACTION

Gresham's Law in Operation

The first way in which the public reacted to notes of dubious value was quite to be expected. In keeping with Gresham's law, bad money drove out good. Notes of banks of debatable or unknown soundness circulated, and notes of banks known to be sound were saved or were converted to specie which then was saved. No one wanted to be caught with worthless currency, so the public spent the questionable notes first. Gresham's theory was operative through the entire period of banking in the United States from its inception to the end of the state-banking period under discussion.

The second way in which the public reacted to the lack of convertibility of this paper currency seems strange at first. It came to be considered a disgraceful act to request one of these banks to keep the promise boldly printed on the face of its every note, and attempts at conversion came to be regarded as indicative of a lack of public spirit or of a desire to start a "run."

Needless to say, in a fractional specie reserve system, any major attempt to convert bank notes into gold or silver coin very soon would cause trouble. This would occur not only at the bank on which the particular notes were drawn, but almost surely would trigger similar attempts to convert notes of other banks in the same area. In cases,

for example, in which a bank kept only seven per cent or so in specie as a reserve against its entire note issue, it would be forced to suspend redemption of its notes before this reserve was exhausted, and the suspension point would soon be reached. Obviously, the least rumor of threatened suspension could start what amounted to a local panic and could force total suspension by all the banks in the area. In those cases where total capital never had been paid into the bank, the cutoff point was reached considerably sooner, and the attendant public reaction was even stronger.

Since a wildcat bank was notoriously short of specie reserve, a run on such a bank would be disastrous; all its outstanding currency would become valueless. Whereas people preferred to use coin rather than bank notes, they knew there was not enough coin to serve all the needs of business, and they accepted the fact that they had to use at least a certain amount of currency. In the light of their awareness of the situation, their reaction is not so strange as it first appears. Lest a run should start, any attempt at currency redemption came to be looked upon as an act to be condemned. "In Ohio, Indiana, and Missouri, between 1855 and 1859, certain persons who presented notes for redemption were threatened with lynching or a coat of tar and feathers."[161]

Comments regarding the deplorable activities of the first bank in Indiana reveal the widespread lack of understanding of the "economic and political, as well as the moral laws governing banking." Many of the rugged individualists

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[161] Charles J. Bullock, Essays on the Monetary History of the United States, The Macmillan Company, New York, 1900, p. 85.

"...thought 'wildcat' banking morally justifiable. The economic demands for a bank were either unknown or unheeded, and banks, like railroads and canals, were established where wealth and business interests could not sustain them. Moreover, Jeffersonian and Jacksonian democracy taught that government should interfere as little as possible in the business affairs of men. Bankers, like merchants, manufacturers, or farmers, should be left to carry on their business in the ways that seemed to them best or most profitable. Lastly, there was no publicity given to the business. The few newspapers then in circulation had no adequate means of getting information concerning the banks in time to warn the people. Under such circumstances dishonest men could ply their trade with great success."[162]

Attempts to Legislate Correction

The reader should not be misled into thinking the state legislatures were either unaware or uncaring as to the evils that often attended free banking. Also, there were continuing efforts at the Federal level for action to bring order and safety to the banking system, including unsuccessful attempts to charter a third Bank of the United States. By the beginning of the 1860's one of the best banking systems in the world had been developed by Massachusetts, the Safety Fund system and the bond security system had evolved to a stage of perfection in the State of New York, and honest bank management was the rule rather than the exception.[163]

To a great extent, legislative action came only after a great scandal connected with banking. For example, Indiana, following the disastrous actions of the Bank of Vincennes, enacted better laws, and ultimately developed the State Bank of Indiana into one of the best of the state-chartered institutions of the period.

Louisiana enacted in 1842 what was considered to be a model banking law. In the words of William Sumner, it was "The most remarkable law

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[162] Logan Esarey, State Banking in Indiana 1814-1873, Indiana University, 1912, pp. 241-242.

[163] Bullock, p. 91.

to regulate banks, which was produced in this period, in any State...."

It contained

> "...remarkably clear and direct language, entirely free from legal verbiage. It leaves the impression of a schoolmaster who, having got tired of confusion, insubordination, and misbehavior, takes in hand the duty of restoring order, and distributes punishments, corrections, and new orders in the most peremptory manner."[164]

Without going into the considerable detail involved, in essence the law retained the charter requirement; it distinguished between loans on capital and loans on deposits, with restrictions as to their maturity and the collateral to be pledged against them. Extensions in the "accommodation paper" manner were forbidden, and any one who applied for an extension was to have his account closed and notice of this action given to other banks.[165]

The law authorized a Board of Currency comprised of three salaried individuals, charged with the supervision of banks. Banks were to submit detailed weekly statements, to publish a statement monthly, and to report annually to the legislature. A unique and particularly interesting facet of the law was a requirement that each member of the Board of Currency was required to be bonded in the amount of $5,000, and the individual could be sued on the bond should he fail to carry out his duties as prescribed. Banks were subject to a fine for violating Board orders.[166]

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[164] William Graham Sumner, "A History of Banking in the United States," A History of Banking in All the Leading Nations, Vol. I, Edited by the Editor of The Journal of Commerce and Commercial Bulletin, The Journal of Commerce and Commercial Bulletin; New York, 1896, p. 387.

[165] Sumner, p. 387.

[166] Sumner, p. 388.

This law "obviously proceeded from very mature study of the principles and practices of banking, and may justly be regarded as one of the most ingenious and intelligent facts in the history of legislation about banking." Unfortunately, it

> "...remained unmodified only thirty days; then another act was passed modifying and softening it in many details. The administrative officers also flinched from the execution of it in all its severity, but, even so, it put the banking of Louisiana on a plane far above that of any other State and held it there until the civil war."[167]

Maryland banking appears to have been much more conservative than banking in many of the other states. For example, between 1820 and 1864 there were only two bank failures in Baltimore. Maryland's general banking law did not contain the free banking features that characterized legislation in other states.[168]

There are indications that, in the absence of legislative action, private groups in some states attempted to effectuate corrective measures. One such action took place in 1858 in Illinois when

> "...a number of the private bankers of Chicago threw out the notes of twenty-seven Wisconsin banks because the currency had been greatly increased by banks that were located at inaccessible points, having no capital, doing no banking business, providing no means whatever for the redemption of their issues, and in many instances having not even an office or known place of redemption."

These circumstances caused 45 Wisconsin banks to associate for the purpose of forcing redemption of currency on a number of their confreres

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[167] Sumner, p. 389.

[168] Alfred Cookman Bryan, "History of State Banking in Maryland," Johns Hopkins University Studies in Historical and Political Science, Herbert B. Adams, Editor, The Johns Hopkins Press, Baltimore, January 1899, pp. 133-134.

whose banks were considered "wild."[169] There is no evidence that such private groups were so numerous or so strong as to bring about any meaningful improvement. Because free banking had gotten such a bad name from the wildcat operations in the earlier states, in many of the newer states banking was specifically forbidden. By 1860, the six banks that had existed in the Territory of Nebraska all had failed. The crisis of 1857 was said not to have brought Arkansas the troubles that plagued the rest of the country, and the people of Arkansas apparently felt this was due to the fact that their Constitution prohibited them from having banks.[170]

The Constitution adopted in California in 1849 specifically prohibited paper currency from serving as money. The only function the California Constitution allowed banking institutions was the provision of safe deposit facilities. Oregon's 1857 Constitution "forbade the existence in the State of any institution whatever issuing notes to serve as currency."[171]

In various other states, individual banks became noted for the capability and integrity of their administration; outstanding among these were the State Banks of Indiana and Ohio, the Bank of the State of South Carolina, and the banking house of George Smith and Alexander Mitchell in Wisconsin.[172]

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[169] Sumner, p. 451.

[170] Sumner, p. 453.

[171] Sumner, p. 454.

[172] Bullock, p. 92.

Unfortunately, these

"...distinguished exceptions merely serve to heighten the contrast presented by most of the banking institutions in the South and West. ... Attempts had been made to adopt the provisions of the banking codes of other states, but the laws thus framed had been badly administered. North of Louisiana and Arkansas, there was practically no convertible bank money in the Mississippi Valley; and the notes of dead or doubtful banks were hawked about at from ten to ninety per cent discount."[173]

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[173] Bullock, p. 92.

CHAPTER XI

WILDCAT BANKING IN RETROSPECT

The Demise of Wildcat Banking

The Winds of Change. The failure of four banks in Albany in the Spring of 1861 generated strong pressure for action on what by then was universally recognized as a serious situation. The state of currency and the banking structure as noted in the last chapter was no secret, nor was it an unknown fact that attempts at legislative correction at the state level in the overall had been generally ineffective. This is not to say that the entire banking system in all the states was in a weakened or extended condition; however, it was clear from the specific failures and weaknesses that the potential was present for more widespread trouble throughout the system.[174]

Speaking of the New York country banks as "mushroom concerns," one of the banking magazines of the day went on to say: "A radical change in the banking system is required in this and particularly in Western States." The magazine commented further that recent events in several states "demonstrated more strongly than ever the insecurity of the bank note currency of those States, and of other States where bank notes are issued on the security of State bonds."[175]

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[174] William Graham Sumner, "A History of Banking in the United States," A History of Banking in All the Leading Nations, Vol. I, Edited by the Editor of The Journal of Commerce and Commercial Bulletin, The Journal of Commerce and Commercial Bulletin, New York, 1896, p. 454.

[175] Sumner, p. 454.

Mr. Sumner referred to this commentary by the bankers' own publication as:

> "...the last general verdict on the old local bank system which we can quote from a friendly source before the upheaval of the whole currency and banking system by the civil war. If there had been no war, the banking and currency system of the country would have been a pressing, distressing, and unsolved problem. If the then-existing system was satisfactory, we find no proofs of it in the literature where that fact should have found expression."[176]

Thus, it was the convergence of financial and political events that created the climate in which genuine remedial measures might be adopted.

National Bank System Initiated. The National Bank Act was passed in February of 1863, and a new era began in American monetary history. The Act contained many beneficial features, but the greatest benefit apparent to the man in the street was that it provided the framework for a uniform and sound currency, and it marked the beginning of the end of wildcat banking.

Inasmuch as banks were not required to join the national system, the National Bank Act alone was not enough to eliminate the issuance of state bank currency. Additional "teeth" were provided in the law in 1865 when a tax of 10 per cent was levied on currency issued by state banks after July 1, 1866. As a result, most of the state banks joined the national banking system.[177] An interesting sidelight is the indication of strong Congressional opposition to this tax feature that dealt the final blow to state bank currency of all kinds; this section of the law was passed in the House of Representatives by a majority of but one vote.[178]

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[176] Sumner, p. 454.

[177] Sumner, p. 457.

[178] Sumner, p. 454.

Links Between Early Banking Climate and State Bank Supervision

As stated earlier, the purpose of this thesis was to present some of the colorful, adventurous, picturesque side of early American banking, particularly that known as the wildcat banking era, and at the same time, to show links between unsound or questionable banking practices and the development of state bank supervision. As research progressed, several facts became obvious.

The first such fact to become apparent was that the links between bad banking practices and laws that prevented them did not bear the immediate cause-and-effect relationship one would expect. Prompt legislative response would have seemed likely, especially after an evil practice had wrought widespread damage such as that accruing to a community when its local bank failed. But seldom did the responsible officials act quickly or decisively and devise significant innovative features to close the loopholes that appear so obvious today.

Later, when there emerged a trend toward delegation of the bank supervisory function by state legislatures to some individual or supervisory group, the legislatures either deliberately withheld or inadvertantly omitted the necessary authority for the bank supervisor(s) to take action. Moreover, even when the individual or group was authorized to act in a supervisory way, there seldom was any provision for forcing the banks to comply. In today's highly developed supervisory structure, it is difficult to imagine that someone then charged with supervisory responsibility could not force the banks in his jurisdiction to submit reports, otherwise make information available, or permit on-premises inspections.

Some states actually did not perform a bank supervisory function during the entire state banking period. These states initiated such a function only after the national bank system had come into being. In a sense, this action was in the tradition of the proverbial locking of the barn after the horses were gone, for the conversion from state to national charter was extremely heavy at this point in time.

The first reaction to the above findings is one of surprise. Why did the states in general not provide better banking laws and a better bank supervisory system over the years prior to the initiation of the Federal system of banking and bank supervision? Why did a supervisory structure not develop concomitantly with the banking system? There is no simple answer; rather, there are a number of vital factors that must be considered.

Experimental Nature of System. The first factor is the nature of the state banking system. This can be gleaned from books dealing with the subject of banking, but seldom is its experimental characteristic pointed out per se. Certainly, banking in this country from the earliest Colonial days was experimental; there was no precedent, nor could there have been one. The American banking system had to be unique because it developed to suit the needs of a unique situation in a unique geographic and socioeconomic environment.

True, certain facets of other systems could be adopted or adapted, but how could operations patterned after the old and staid and settled Bank of England--or any other of the Old World banking systems--operate successfully in the American wilderness? The degree to which known systems needed revision in order to adapt them to American circumstances entailed such major changes as to result not in an adaptation but in a

new banking system. In such circumstances, a certain amount of trial and error was inevitable as the experiment progressed, and a great deal more credit should be given the legislators and men of finance for what in retrospect must be viewed as a remarkable achievement for their time.

Socioeconomic Environment. There is a temptation to be too effusive in describing the great pioneer spirit that motivated people to abandon the relative comfort and security of their previous homes in order to venture into the wilds of the forests and the plains beyond, enduring hardships and overcoming countless obstacles. Yet, the spirit and characteristics of the people definitely influenced the banking system that emerged, and represent a factor that warrants comment.

The wildcat practices could not have been employed in other times in other places, but were conceived and tolerated by these rugged individualists, bold and daring by nature, who tended to use expedience whenever possible and let the end justify the means. Could it not be only in frontier society that people could think of tarring and feathering, not the wildcat banker whose shaky institution deserved their condemnation, but the innocent holder of bank notes who wished to convert them to gold in accordance with their printed promise?

These personality traits of the frontier spirit are responsible for the years of lack of a national system of banking or any organized and supervised bank in the United States. It was the prevailing laissez faire, anti-establishment, anti-regulation attitude of the agrarian West that generated such hatred and opposition to the concept of Federal "interference" in banking.

The free enterprise spirit manifested itself in the free banking laws. Unfortunately for bank supervision at that particular period, it

served also to keep these specific enterprises free of governmental intervention and/or control to the utmost extent. This was an integral part of the political thinking of the times, and it meshed perfectly with the prevailing economic theory that continued to be influenced by the law-of-the-market-place tenets of Adam Smith.

On the other hand, the sometimes uncharacteristically permissive attitude toward shady banking allowed continuation of essentially the only available source of a circulating medium, loans, and other banking services. Questionable as some of the banks were--there was no alternative. Even bad currency in such situations was better than no currency at all in the frontier areas, and even a wildcat bank conceivably could have some salutary effects on economic growth. The resistance to a national system of banking certainly was the foundation of the unique dual banking system in America today, a system in which the states and the Federal government share responsibility for the banking system. In a sense, the dual system contains aspects of the checks-and-balances theory which is an inherent feature in American political tradition.

Political Influence. Undoubtedly, political influence was a significant contributing factor to the system of banking, and especially to the laxity and ineffectiveness of so many of the banking laws. First, there was the composition of the legislative body. These were men of the people and, particularly in the less developed areas in the western tiers of states, they often were lacking in any experience, knowledge, or expertise in matters of banking and finance. The combination of lack of legislative background and general opposition to governmental interference was not conducive to enactment of enlightened banking laws or to creation of adequate enforcement mechanisms.

A more serious flaw in the legislative process was the presence of political influence. Frequently, individuals in the legislatures were in some way personally interested in the charter being sought, and elements of graft and corruption entered into the decisions. Even after the widespread adoption of free banking, legislators often were interested in particular banks, and hesitated to act against their own selfish interests by enacting corrective statutes or by granting supervisory power to independent authorities.

It is so easy to point to the weaknesses of the legislative process and to specific cases of political influence and self-dealing, the more important overall picture tends to be overlooked. In view of the inexperienced, inexpert approach of many of these individuals, it is amazing they could devise such methods and laws as the Suffolk System, the New York Safety Fund Act and other pieces of legislation which provided so much of the essence of modern American banking theory and practice.

Progress of Economic Theory. The development and general awareness of economic theory had not yet reached the point at which the true economic role of the bank was recognized and understood. There are numerous instances throughout banking history in which states sought to ease the plight of debtors by creating banks that were nothing but money machines. Repeated periods of expansion and contraction of money were causing financial panics and bringing great personal hardship to the people, but no remedy was to be forthcoming for many years, and an adequate solution almost certainly could never have been developed at the state level.

This lack of appreciation of the role a bank could play in the community also was evidenced by the adherence to the old commercial banking doctrine and the absence of credit provisions geared to longer-term loans,

regardless of their worth. No amount of bank supervision could alleviate the problems of a bank heavily involved in "accommodation" lending when a period of contraction occurred.

Again, acknowledgement must be given the forethought of those who, whether or not cognizant of the validity of longer-term lending per se, nevertheless recognized the need and provided, through the imperfect means then available, the medium-term and long-term needs for capital expansion and economic growth. Both were sorely needed during the period, and their satisfaction undoubtedly contributed to the overall growth of the American economy. It later years, it would be recognized that longer-term lending was a necessary and legitimate function of banking, and that the real culprit was not the terms of the loans so much as the inelasticity of the money supply.

Inadequate Managerial and Supervisory Talent. There probably were sufficient numbers of qualified men in the early period, particularly immediately following the merchant-banker stage, to carry out the banking function with reasonable skill. With the great proliferation of banks, however, it must have been difficult to employ experienced men to operate the institutions. Various writers have indicated that a significant number of abuses in banking in the era of wildcat practices can be attributed to bumbling and incompetence; dishonesty was not always the cause. This, of course, does not apply in the case of the wily individual operating the thoroughgoing wildcat bank.

Further, political favoritism operated to limit potential candidates for a post to those of acceptable political persuasion. This was true both as to bank posts--directors and officers--and bank supervisory posts--bank commissioners or inspectors.

Given these conditions, it is remarkable that so much managerial and supervisory talent could be developed. It is to their credit that these men could enter a line of business unknown to them, and could acquire the skill necessary to operate it. In relating wildcat practices, there is a tendency to minimize the more sound and conservative institutions, but they existed in substantial numbers, especially in the older areas along the East Coast.

A Retrospective Appraisal

In the light of the factors enumerated above, it becomes less difficult to comprehend how early legislators and bank supervisors failed to perceive and to remedy the flaws in the banking system as promptly and brilliantly and effectively as retrospective judgment demands. In fact, contemplation of the newness of the entire concept of banking as applied to the new environment, together with the lack of expertise, the unusual temperament of the people, the unusual needs of the new land, and all the other factors present, paints a picture that is far more commendable than reprehensible.

At first glance, these factors considered on a state-by-state basis present a hodgepodge that leads to the pessimistic conclusion reached at the end of the last chapter that there really was no genuinely coherent, strong, adequate structure of banking or its supervision. And yet, further reflection reveals that all the threads that later were to be woven into the structure of a sound banking system and adequate supervision were there, waiting for the unifying force that would bring them into a single fabric.

This unifying force turned out to be the National Bank Act. The most important aspect of this legislation for purposes of this paper is

that the new law was not really new. The understandable trial and error approach of the early years provided justification and explanation for eliminating by the means of national law many of the flaws in the earlier methods. Actually, the new law was modeled largely on such earlier landmark developments as the Suffolk System, the supervisory provisions of the Safety Fund Act, and the Free Banking Act of New York. This retrospective approach permitted the Federal statute to strengthen the weaknesses and close the loopholes in the earlier vehicles and to eliminate their unwise and unworkable features.

The provisions of the Act were much the same as those of various states, including those under which the wildcat banks had flourished; the difference was that they generally were much more stringent. For example, each national bank was restricted in the issuance of currency to an amount not to exceed its capital; as security for its note issue, the bank had to pledge Government bonds at 90 per cent of par. The law also provided for the appointment of qualified individuals to examine banks, to submit reports as to their condition, and to require correction of various matters deemed unsatisfactory.

Bank supervision as we know it today necessarily must include great consideration for the Federal bank supervisory agencies, and most works on banking and bank supervision dwell almost exclusively on the period beginning with the National Bank Act. Admittedly, establishment of the national system of banking was an important development in bank supervision and regulation, but most aspects of this phase of banking history belong to the period that followed, that is, the national banking era. The relationship between the two periods too often is overlooked or minimized. As noted above, the National Bank Act was comprised almost

entirely of provisions of then existing state legislation that time had proved effective. The principal contribution of the national legislation was its enhanced enforcement provisions and its national scope, which permitted the bringing together of the best features of the various state banking laws. This, in turn, tended to encourage greater uniformity in subsequent banking legislation by the states.

A number of states established departments for supervising and examining banks only after passage of the National Bank Act. In various other states, new laws were formulated to oversee banking; most of these incorporated supervisory provisions of the National Bank Act. Thus, one might characterize the process as something of a circular flow of influence; the supervisory aspects of the National Bank Act were inspired by like provisions of state banking laws and, in turn, inspired the enactment of meaningful banking statutes in other states.

In the final analysis, the strength and character of the national legislation was derived from its national scope and its stronger enforcement provisions rather than from any genuinely innovative features. The latter belong to the earlier period of banking in the United States. The author, in recognition of this fact, herewith pays tribute to that colorful era and to the men of vision who provided the groundwork on which the present structure could be built.

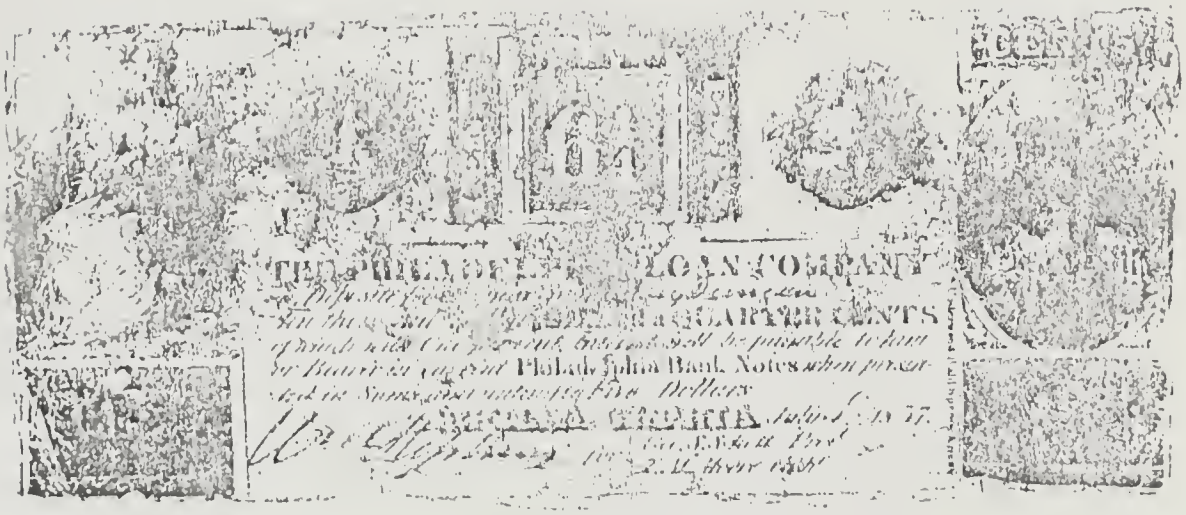
EXHIBITS

CURRENCY

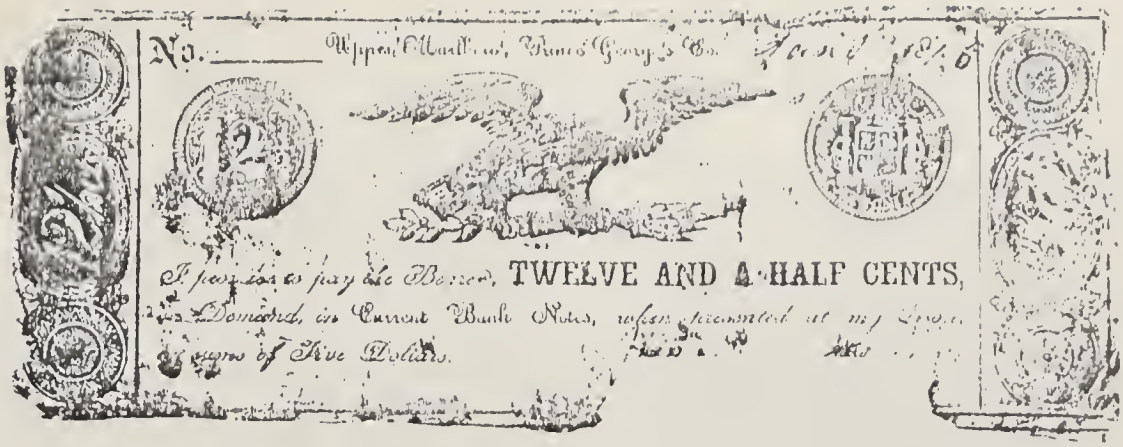
AND

CURRENCY VARIATIONS

THE COLUMBIA BANK, WASHINGTON, D. C.
"Will pay ONE DOLLAR to the bearer on demand."
Oct. 20, 1852. Legend on top border: CAPITAL STOCK $100,000. SECURED BY PLEDGE OF $100,000. PENNSYLVANIA 6 PER CENT BONDS.

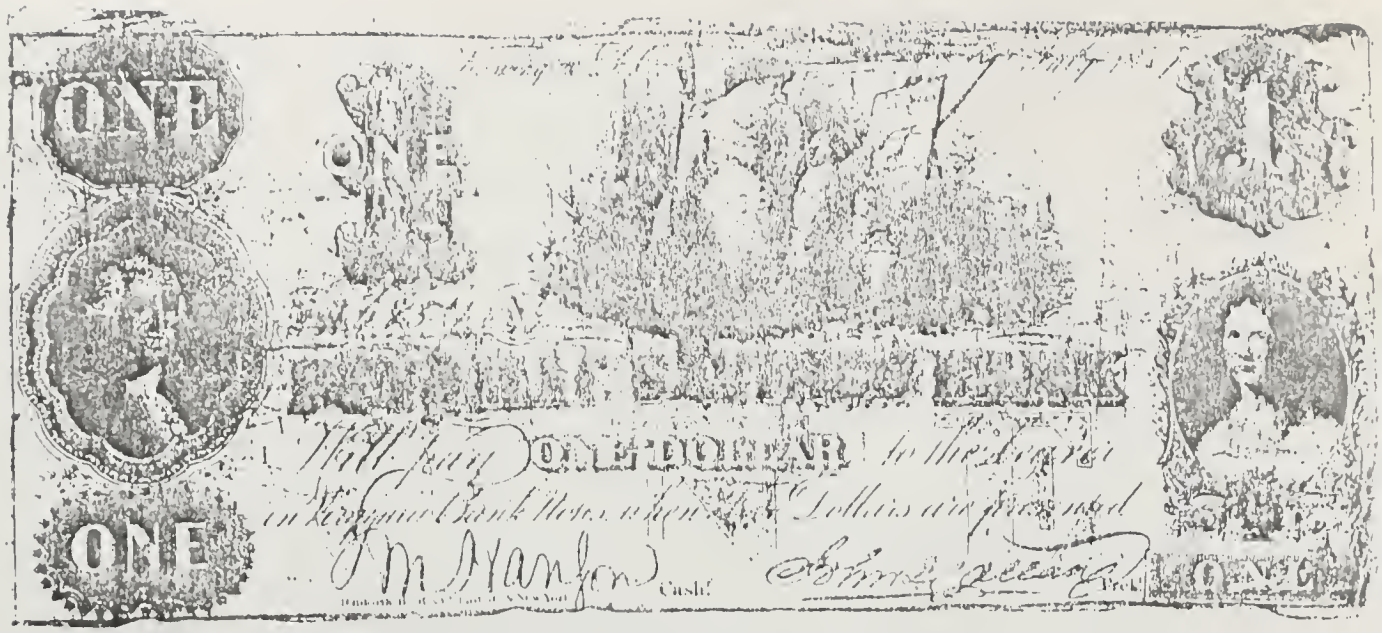


"Received by THE PHILADELPHIA LOAN COMPANY on Deposite for One year from Benj. Duncan Ten thousand Dollars, SIX and a QUARTER CENTS at which with One per cent Interest will be payable to him or Bearer in current PHILADELPHIA BANK NOTES when presented in Sums amounting to FIVE DOLLARS."
July 4, 1837

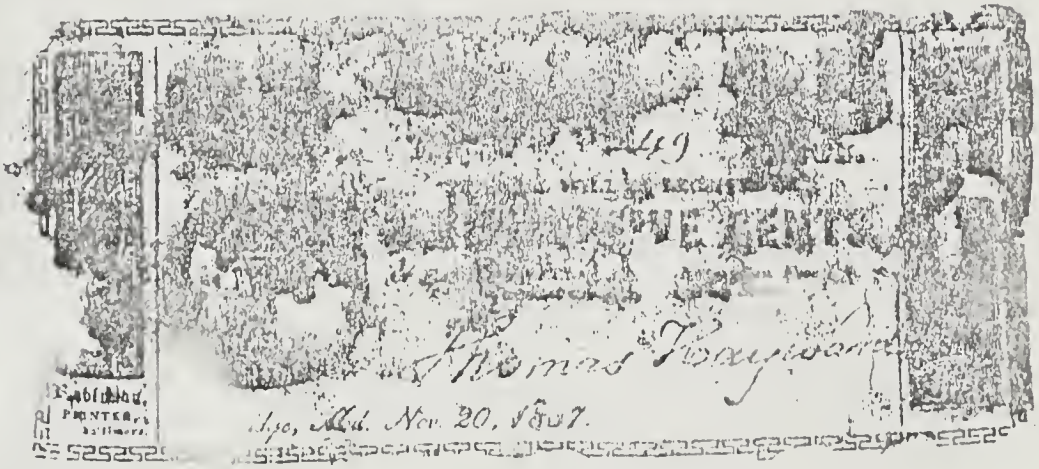


"Upper Marlboro, Prince George's Co. Jan. 1, 1846.
I promise to pay the Bearer TWELVE AND A HALF CENTS
on Demand in Current Bank Notes, when presented at
my Store, in sums of Five Dollars. [signature missing]"

VAUXHALL DRINKING INSTITUTION
"Certificate for SIX AND A QUARTER CENTS, part of a
deposit made by JONATHAN SLICK payable in Rum."
Baltimore, Nov. 8, 1839.



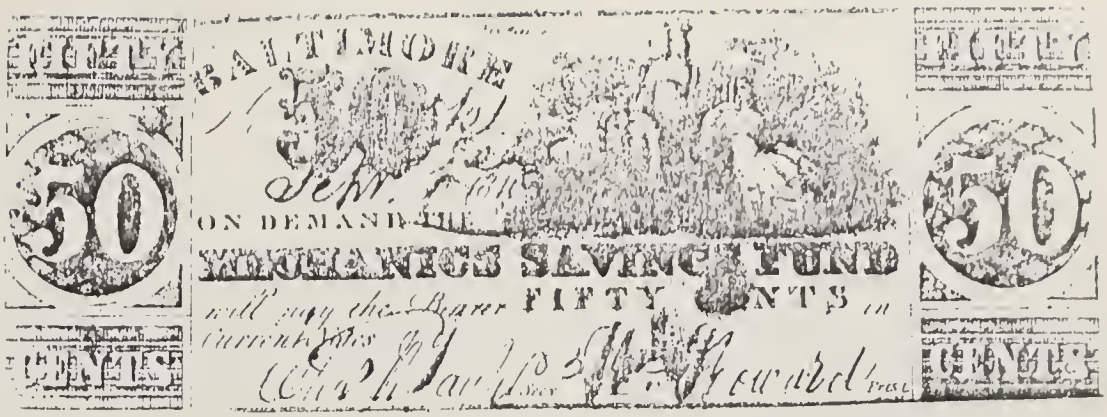
POTOMAC SAVINGS BANK, WASHINGTON, D. C.
"Will pay ONE DOLLAR to the bearer in Virginia Bank Notes when Five Dollars are presented." Dated July 1851



"This bill will be received for TWENTY-FIVE CENTS or Exchanged for Current Bank Notes when Five Dollars in amount are presented at my Store.

Thomas Hayward

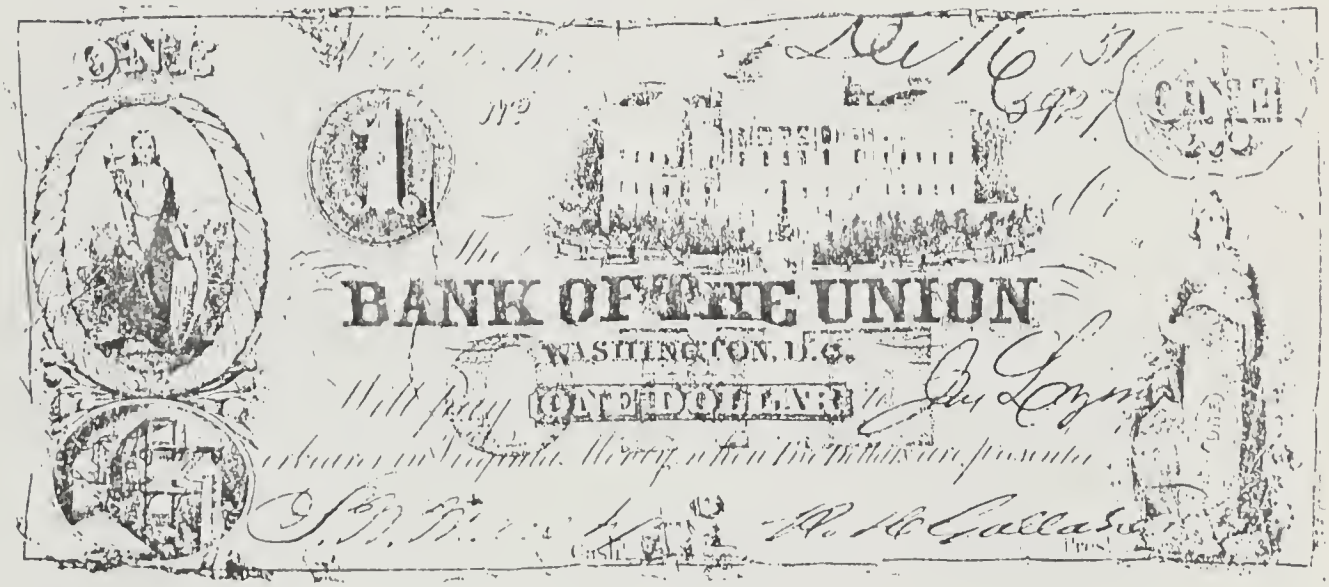
Cambridge, Md. Nov. 20, 1837



THE MECHANICS SAVINGS FUND, Baltimore, Md.
"Will pay the Bearer FIFTY CENTS in Current Notes."
Sept 1st 1840.

THE HAVRE-DE-GRACE BANK, HAVRE-DE-GRACE, MARYLAND
"Will pay ONE DOLLAR on demand to the bearer."
Nov. 18th, 1846

THE MERCHANTS BANK, NORWICH, CONNECTICUT
"Will pay FIVE DOLLARS to the bearer on demand."
Sept. 11, 1857



THE BANK OF THE UNION, WASHINGTON, D. C.
"Will Pay ONE DOLLAR to Jay Laziny or bearer in
Virginia Money when Five Dollars are presented."
Dec. 16, 1851.

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